TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1930

No. 425

GROUP NO. 1 OIL CORPORATION, PETITIONER,

vs.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 6, 1930

CERTIORARI GRANTED NOVEMBER 24, 1930

(35,347)

(35,347)

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[fol. a-1] [Caption omitted]

[fol. 2]

IN UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS, AUSTIN DIVISION

No. 1176. At Law.

GROUP No. 1 OIL CORPORATION, Plaintiff,

vs.

JAMES W. BASS, United States Collector of Internal Revenue, Defendant

PLAINTIFF'S ORIGINAL PETITION—Filed Sept. 23, 1929

To the Honorable Judge of said Court:

Comes now Group No. 1 Oil Corporation, a corporation organized under the laws of the State of Delaware, hereinafter called plaintiff, and files this its original petition, complaining of James W. Bass, as Collector of Internal Revenue for the United States for the First District of Texas, hereinafter called defendant, and shows to the court as follows:

I

Plaintiff is, and has been at the various dates hereinafter alleged, a corporation organized under the laws of the State of Delaware, with its principal office in El Paso, El Paso County, Texas.

II

Defendant is, and was on the various dates hereinafter alleged, the duly appointed, qualified and acting United States Collector of Internal Revenue for the First District of Texas, which District includes El Paso County, Texas, and as such Collector he was invested with the power and authority to collect taxes upon the income of persons and [fol. 3] corporations within said District that were levied and assessed under and by virtue of the Acts of Congress

designated as the Revenue Acts of 1924, 1926 and 1928. The residence of the defendant is at Austin, Travis County, Texas.

III

The plaintiff's cause of action is to recover from the defendant the amounts of income taxes paid by the plaintiff to the defendant for the fiscal years and fiscal period beginning July 1, 1924, and ending March 31, 1928, with legal interest thereon from the dates of their payments, that plaintiff alleges were wrongfully, illegally and without authority of law collected from the plaintiff by the defendant, all as set forth hereinafter in detail.

IV

Under and by virtue of the provisions of the Revenue Acts of 1924, 1926 and 1928, and the rules and regulations prescribed by the Commissioner of Internal Revenue and the Secretary of the Treasury in connection therewith, plaintiff made out, signed, executed and returned to defendant its returns of its income from all sources for the fiscal years and fiscal period hereinafter set out, which returns were made out in accordance with forms prescribed by the Commissioner of Internal Revenue and were filed with the defendant within the times prescribed by said Revenue Acts.

V

Upon the income of the plaintiff as shown by its said income tax returns the Commissioner of Internal Revenue [fol. 4] applied the rates of income taxes provided under the Revenue Acts of 1924, 1926 and 1928, for the corresponding periods and as a result thereof assessed against the plaintiff as its income taxes for the periods of time covered by said returns the following sums, which the plaintiff paid to the defendant on or about the following dates, to-wit:

For the fiscal year beginning July 1, 1924, and ending June 30, 1925:

November 16, 1925	$5,000.00
December 11, 1925	4,882.55
March 9, 1926	4,941.27
June 9, 1926	4,941.27
April 28, 1926	395.31
Total	$20,160.40

For the fiscal period beginning July 1, 1925, and ending March 31, 1926:

June 11, 1926	$115,308.87
September 15, 1926	115,308.87
December 14, 1926	115,308.87
March 18, 1927	115,308.87
Total	$461,235.48

For the fiscal year beginning April 1, 1926, and ending March 31, 1927:

June 16, 1927	$60,545.46
September 15, 1927	60,546.12
December 16, 1927	60,545.79
March 20, 1928	60,545.79
Total	$242,183.16

For the fiscal year beginning April 1, 1927, and ending March 31, 1928:

June 15, 1928	$3,398.71
September 11, 1928	3,398.70
December 15, 1928	3,021.06
Total	$9,818.47

[fol. 5] In addition to said taxes for the said fiscal year ending March 31, 1928 there was assessed against plaintiff for said year a further amount of$3,398.74 which it paid to the defendant on or about March 18, 1929, after it had filed its hereinafter mentioned claims for refund, and only because the same was not included in its said claims for refund plaintiff does not seek to recover that amount in this present cause.

VI

All of the income of the plaintiff during said fiscal years and fiscal period, on account of which said income taxes

were assessed against the plaintiff by the United States government and collected by the defendant, was derived (except as hereinafter specified) from the sale of oil and gas produced by plaintiff under oil and gas permits and leases from the State of Texas upon a part of the public domain of said State of Texas and from operations carried on by plaintiff under said oil and gas permits and leases from the State of Texas and from its operation and enjoyment of its rights, privileges and franchises under said permits and leases. Copies of said leases are attached hereto and marked, respectively, Exhibits A and B. The tracts of land covered by said permits and leases from which it produced said oil and gas and upon which it carried on its said operations were Section Thirty-six (36) of Block Nine (9) and Section One (1) of Block (8), University of Texas lands in Reagan County, Texas.

Of plaintiff's said income, on account of which said income taxes were assessed by the United States and paid by plaintiff, only the following amounts were derived from [fol. 6] sources other than those specified in the next preceding paragraph hereof, but from the said taxable income are to be deducted the following expenses and deductions not connected with the production of said oil and gas and operations under said permits and leases, and which are allowable deductions under the Revenue Acts of 1924, 1926 and 1928, respectively, against said other taxable income, to-wit:

For the fiscal year from July 1, 1924, to June 30, 1925:

Gross Income			
Interest received			$1,481.21
Total			1,481.21
Deductions			
Interest paid		$1,887.09	
Travel expenses		8,049.96	
New York Office Expense		2,251.31	
Legal and Auditing Fees		79,877.16	
Taxes Paid:			
Filing fees	$21.00		
Gross Production Tax	51,876.73		
State & County	58.63		
Capital Stock	808.75		
Beginning Tax	55.00		
Franchise	20.00		
Revenue Stamps	75.00		
		52,915.11	
			144,980.63
Net Loss			$143,499.42

For the fiscal period from July 1, 1925 to March 31, 1926:

Gross Income

Interest received			$24,350.91
Total			24,350.91

Deductions

[fol. 7]

Traveling Expenses		$12,878.98	
Registrar Fees		303.16	
Directors Fees		120.00	
Legal and Auditing Fees		94,826.24	
Taxes Paid:			
Gross Production Tax	$167,034.90		
State & County	911.62		
Automobile Licenses	323.91		
Capital stock	9,742.00		
Transfer Tax	325.00		
Filing Fees	3.00		
		178,340.43	
			286,468.81
Net Loss			$262,117.90

For the fiscal year from April 1, 1926 to March 31, 1927:

Gross Income

Interest received	$112,713.48
Profit on sale of lease on Settles Block in Howard & Glasscock Counties, Texas	2,094.32
Total	$114,807.80

Deductions

Rentals paid on oil & gas leases on privately owned lands		$4,337.23	
Cost of drilling dry wells on leases on privately owned lands		103,560.33	
Legal and Auditing Fees		270,301.33	
Traveling Expenses		14,803.75	
Registrar Fees		400.00	
Engineering & geological expenses in connection with privately owned lands		2,910.23	
Directors Fees		170.00	
Advertising		311.00	
Taxes Paid:			
Gross Production Tax	$135,470.16		
State & County	58,521.90		
Automobile Licenses	1,328.00		
Franchise	1,302.62		
		196,622.68	
[fol. 8] Amortization of non-productive leases on privately owned lands		6,003.90	
			599,420.45
Net Loss			$484,612.65

For the fiscal year from April 1, 1927 to March 30, 1928:

Gross Income			
Interest received			$21,252.98
Sales of oil produced from leases on privately owned lands			8,479.96
Profit on sale of leases on privately owned lands			2,769.37
Total			$32,502.31
Deductions			
General operating expenses on leases on privately owned lands		10,897.63	
Rentals on leases on privately owned lands		11,705.56	
Abandoned leases on privately owned lands on cost basis		25,233.44	
Cost of drilling dry wells under leases on privately owned lands		85,708.33	
Traveling Expenses		12,865.51	
Legal and Auditing Fees		41,156.45	
Registrar Fees		605.30	
Directors Fees		80.00	
Taxes Paid:			
Franchise & Filing (Texas)	$6,947.00		
Franchise & Filing (Delaware)	22.00		
State, County and School	53,690.44		
Production Tax	47,325.02		
Automobile licenses and taxes	1,021.57		
		109,006.03	
			297,258.25
Net Loss			$264,755.94

[fol. 9]

VII

Said tracts of land, from which plaintiff produced said oil and gas and in connection with which it carried on its said operations under said oil and gas permits and leases from the State of Texas, are a part of the public domain of the State of Texas, and have always been a part of the public domain of said State and of the Republic of Texas and of the Governments preceding the Republic of Texas. Said lands, before said permits and leases thereon were executed by the State of Texas, had been appropriated and set aside by the State of Texas for the endowment, maintenance, support and benefit of the University of Texas, a university established and maintained by the State of Texas for the promotion of literature and the arts and science.

VIII

In order for the State of Texas to secure the development of its mineral resources, including oil and gas, in and

under said lands and realize upon its interest in these minerals and convert them into money for the benefit of said state and of the University of Texas, the said State of Texas enacted Chapter 83 of the Acts of the Thirty-fifth Legislature of March 16, 1917, which Act was modified in certain particulars by Section 17 of Chapter 81 of the Acts of the Thirty-sixth Legislature, Second Called Session, of July 31, 1919, Chapter 6 of the Acts of the Thirty-seventh Legislature of February 1, 1921, and by other acts of the Legislature of said State. Said Acts provided for the issuance of permits for prospecting on said lands, among others, for oil and gas, among other minerals, and further [fol. 10] provided that, upon certain conditions set forth in the Acts being performed, the owner of such a permit could obtain a lease from the State of Texas upon the land covered by his permit giving him the right during the term thereof to develop and operate said land for the production of oil and gas therefrom, the State of Texas receiving a stated sum per acre each year during the life of the lease, and in addition a royalty of one-eighth of the value of the gross amount of oil produced therefrom and one-tenth of the value of the meter output of all gas disposed of off the land, said royalties being paid monthly. The Commissioner of the General Land Office of the State of Texas was given authority to incorporate in such leases such other terms as he might deem important to protect the interests of the State, including the right to require the lessee to drill offset wells to prevent drainage by wells on adjacent private land.

Under the provisions of said Acts, the said leases, hereinbefore referred to and copies of which are attached hereto as Exhibits A and B, were issued by the State of Texas, and plaintiff became the owner of said leases in so far as said Section Thirty-six (36) of Block Nine (9) and Section One (1) of Block Two (2), University of Texas lands in Reagan County, Texas, were concerned.

Said leases are here referred to for all their terms and provisions and for all purposes as if fully set forth herein. Said leases, in addition to reserving the statutory royalties and incorporating the provisions required by the Statutes, provided among other things: (1) the lessee was required to proceed with reasonable diligence to develop and operate the property for oil and gas, and to operate each pro-

ducing well with reasonable diligence and in a bona fide [fol. 11] effort to produce the oil and gas therefrom; (2) the lessee was required to drill, either voluntarily or when requested by the Commissioner of the General Land Office, such offset well or wells as might be necessary to protect the area leased from any well or wells that might be drilled on private land in the same vicinity and within such proximity as to render offset wells reasonably necessary for the protection of the leased property; (3) if the lessee failed to proceed with reasonable diligence to develop and operate the properties or to produce the oil and gas that could be produced from wells, or to pay any royalties when due, or to comply with any provisions of the leases, or to comply with any other regulations adopted by the Commissioner of the General Land Office which were reasonably necessary for the proper execution of the provisions of the Statutes relating to said leases, the leases were subject to forfeiture because thereof.

IX

The United States and the defendant as the Collector of Internal Revenue of the United States had, and have, no power or authority to levy, assess or collect the said income taxes, as hereinbefore set forth, that they have collected from the plaintiff on account of its said income derived from the sale of oil and gas produced by it under said permits and leases from the State of Texas and from its operations under said permits and leases and from its operation and enjoyment of its rights, privileges and franchises under said permits and leases, and their collection of said income taxes from the plaintiff was and is in violation of and contrary to the Constitution of the United [fol. 12] States and was wrongful, illegal and without authority of law, all for the following reasons, among others:

1. Said income tax is a tax upon and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples, arrests and is in derogation of, the power and right of the State of Texas to develop and realize on its oil and gas resources in and under its said lands for the benefit of itself and its instrumentality, the University of Texas, and if the United States government had the power to levy, assess and collect such taxes, this power could be used by the

United States government to destroy and render valueless said power and right of the State of Texas.

2. Said income tax is a tax upon and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples, arrests and is in derogation of, said permits and leases issued by the State of Texas and chosen and created by said State as means, agencies and instrumentalities for the purpose of exercising and carrying out said power and right of said State to develop and realize upon its oil and gas resources in and under its said lands for the benefit of itself and its instrumentality, the University of Texas, and if the United States government had the power to levy, assess and collect such tax, this power could be used by the United States to destroy and render impotent said means, agencies and instrumentalities of the State of Texas.

3. Said income tax is a tax upon, and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples and arrests this taxpayer as a means, agency and instrumentality chosen by the State of Texas, through its ownership of said permits and leases, for the purpose of exercising and carrying out said power and right of said State to develop [fol. 13] and realize upon its oil and gas resources in and under its said lands for the benefit of itself and its instrumentality, the University of Texas, and if the United States government had the power to levy, assess and collect such tax, this power could be used by the United States government to destroy and render impotent this taxpayer as said means, agency and instrumentality of the State of Texas.

4. Said income tax is a tax upon and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples, arrests, and is in derogation of, the rights, privileges, licenses and franchises obtained by said taxpayer under said permits and leases from the State of Texas, and if the United States government had the power to levy, assess and collect such tax, this power could be used by the United States government to destroy and render valueless said rights, privileges, licenses and franchises obtained from said State of Texas.

5. Said rights, privileges, licenses and franchises obtained by the taxpayer under said permits and leases from the State of Texas and said permits and leases are exempt

from taxation by the United States government, and income derived by this taxpayer therefrom is exempt from taxation by the United States government.

6. Said income tax burdens, retards, impedes, hinders, impairs, controls and arrests this taxpayer as said means, agency and instrumentality of the State of Texas, in developing said lands of the State of Texas for oil and gas and producing oil and gas therefrom, and thus prevents the State of Texas from obtaining the greatest return from its royalties on the oil and gas produced from said lands, and if the United States government had the power to levy, as- [fol. 14] sess and collect such taxes, said power could be used by the United States government to prevent this taxpayer from developing said lands for oil and gas and from producing oil and gas from said lands, with the result that the State of Texas could be prevented from realizing anything upon the royalties to be paid to it under said oil and gas permits and leases.

7. If the United States had the power to levy, assess and collect said income tax, this power would have a sensible influence on the terms of said permits and leases that the State of Texas could demand and require. and the consideration that the State of Texas could require, and obtain therefor, and the amount of royalties said State could reserve; and said power could be used to such an extent that the State of Texas would have been required to grant said permits and leases on terms more disadvantageous to it and for less consideration and for less royalties reserved, and could be used by the United States to render it impossible for the State of Texas to realize a reasonable amount, if anything at all, from said permits and leases, and from its said oil and gas resources.

8. Furthermore, under the resolutions and acts of the Congress of the United States and the Congress of the Republic of Texas, and of the convention of the people of the Republic of Texas under which the Republic of Texas became one of the United States, it was definitely guaranteed by the United States government that the State of Texas should retain all the vacant and unappropriated lands within its limits, to be applied to the payment of the Republic's debts and liabilities and the residue of said lands

[fol. 15] to be disposed of as the State of Texas might direct. Said vacant and unappropriated lands included the lands covered by said permits and leases held by this taxpayer. Said income tax is contrary to and in derogation of said guarantees by the United States government that the State of Texas should retain said lands, and use, enjoy and dispose of same as it might direct, and violates said guarantees, agreements and contract between the United States and the Republic of Texas and is a tax upon and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples, arrests, and is in derogation of the rights of the State of Texas in and to said lands, as recognized and agreed upon in said acts and resolutions of the United States government and the Republic of Texas, and is a tax upon and burdens, retards, impedes, abridges, hinders, impairs, controls, cripples and arrests the above mentioned means, agencies and instrumentalities chosen and created by said State of Texas for the purpose of enjoying and exercising its said rights in said lands under said guarantees by the United States government; and if the United States government had the power to levy, assess and collect such tax said power could be used by the United States government to destroy and render valueless said guarantees and said rights of the State of Texas in and to said lands, as recognized and guaranteed by said resolutions and acts of the United States government and of the Republic of Texas, adopted and agreed upon by said two governments as a condition precedent to and in connection with the annexation of the Republic of Texas, and the admission of said Republic of Texas into the United States of America as one of the United States.

[fol. 16] X

On or about November 1, 1928, plaintiff duly filed with the defendant at Austin, Texas, its claim for the refund to it of the said income taxes it had paid to the defendant for the fiscal year beginning July 1, 1924, and ending June 30, 1925. Thereafter, on or about February 14, 1929, plaintiff duly filed with the defendant at Austin, Texas, its claims for the refund to it of all the said income taxes it had paid, as hereinbefore set forth, to the defendant for each of said fiscal years and fiscal period, beginning July 1, 1924, and

ending March 31, 1928, the claim for refund for the income taxes paid for the fiscal year ending June 30, 1925, being an amended claim amending the said claim filed for said year on or about November 1, 1928. A separate claim for refund was filed for each of said fiscal years and fiscal period. All of said claims for refund were prepared, executed and filed in accordance with the laws of the United States and with the rules and regulations prescribed by the Commissioner of Internal Revenue and the Secretary of the Treasury in relation to the preparation, execution and filing of claims for the refund of such taxes. In said claims for the refund of said taxes, plaintiff claimed that said taxes should be refunded to it on the same grounds and for the same reasons as it sets forth in this petition as the grounds and reasons upon which it should recover said taxes of and from the defendant.

[fol. 17] XI

More than six months have expired since the said claims for the refund of said taxes were filed by the plaintiff, but the Commissioner of Internal Revenue has not as yet rendered a decision upon them or upon any of them.

XII

Though the defendant has been duly requested to refund said income taxes thus wrongfully, illegally and without authority of law collected by him from the plaintiff, the defendant has wholly failed and refused and still fails and refuses to refund to plaintiff said income taxes or any part thereof, and there is still due to plaintiff and unpaid all of said income taxes so paid by it, all as more fully set forth in detail hereinbefore, together with interest thereon at the rate provided by law from the various dates the installments of said taxes were paid, all as more fully set forth in detail hereinbefore.

Wherefore, premises considered, plaintiff prays that the defendant be cited to appear and answer this its petition, and that upon a hearing hereof plaintiff have and recover judgment against the defendant for the amounts of all of said income taxes paid by plaintiff to defendant, as more

fully hereinbefore set forth, together with interest thereon at the rate of six per cent (6%) per annum from the respective dates said taxes were paid to the defendant, as more fully hereinbefore set forth, and for all of its costs herein incurred, and for such other and further relief, general and special, to which it may be entitled.

Homer L. Bruce, Baker, Botts, Parker & Garwood,
by Homer L. Bruce, Attorneys for Plaintiff.

[fol. 18] EXHIBIT A TO PETITION.

Oil and Gas Lease No. 8560

General Land Office, Austin, Texas

May 20, 1924.

Whereas the Commissioner of the General Land Office of the State of Texas, did issue the following Permits to Prospect for Oil and Gas under provision of Chap. 83, Act approved March 16, 1917, on University lands in Reagan County, viz:

Permit No. 3914, issued 7-8-19 to Elias G. Krupp on Secs. 5-6-7-8—Blk. 8;

Permit No. 3885, issued 7-7-19 to F. T. Pickrell on Secs. 25-26-35-36—Blk. 9;

Permit No. 3056, issued 7-9-19 to Haymon Krupp on Secs. 5-6-7-8—Blk. 2;

Permit No. 3940, issued 7-8-19 to Frank Gordon on Secs. 13-14-23-24—Blk. 2,

each permit aggregating 2560 acres of land.

Whereas said Permits were extended to a term of 5 years from their respective dates, under provision of Chap. 6, Act approved Feby. 1921.

Whereas under provision of Chap. 81, Act approved July 31, 1919, said Elias G. Krupp, F. T. Pickrell and Haymon Krupp did by instrument dated Nov. 5, 1923, convey to said Frank Gordon all their right, title and interest in and to said Permits Nos. 3914, 3885 and 3956, and in same in-

strument of writing all of said four hereinbefore described Permits were grouped or combined for development purposes under provision of said Chapter 81:

[fol. 19] Whereas by deed dated Nov. 10, 1923, said Frank Gordon did transfer to Edward C. Stearns of Pittsburg, Pa., all his right, title and interest in and to above described Permit No. 3940:

Whereas, by deed dated Nov. 16, 1923, said Edward C. Stearns did transfer to Big Lake Oil Co., all his right, title and interest in and to said Permit No. 3940:

Whereas it having been shown by instrument filed in this office on this May 20th, 1924, that oil was produced in commercial quantities upon Sec. 13, Blk. 2, embraced in said Permit No. 3940, also requesting that lease be issued, accompanying said request for Lease by Log of the well properly sworn to:

Whereas, it appears from the records of the General Land Office that the law has been fully complied with in developing under said Permits and in all things required before obtaining a Lease:

Now, Therefore, Know all men by these presents:

For and in consideration of the premises aforesaid and the obligations hereinafter named, the State of Texas, acting by and through J. H. Walker, Chief Clerk and acting Commissioner of the General Land Office of said State, under the laws of said State, does hereby grant and lease unto the said Frank Gordon & Big Lake Oil Company the area embraced in the hereinbefore described Permits Nos. —. as their respective interest may appear from the records hereinbefore set out in Chapter 81, Acts of 1919, for a term of 10 years with right of renewal, or renewals, together with the right to enter upon said land at all times during [fol. 20] the life of this lease for the purpose of mining, drilling and operating for petroleum or gas, and to erect and maintain all buildings, structures, fixtures, pipes, pipe lines and machinery necessary for the production, the storage and the transportation of petroleum or gas upon the following conditions, viz:

1. The owner of the rights herein conveyed shall pay to the State of Texas at the General Land Office of Texas, at Austin, Texas, a sum of money equal to a royalty of 1/8 of the value of the gross production of petroleum and shall

pay a sum of money equal to 10% of the value of all gas sold. Payments of royalty shall be made monthly and on or before the 15th of each succeeding month during the life of this lease. Payments shall be made either in cash or by exchange on some Bank in Austin, Texas, or by Post Office money order or by Express money order. When payments are made the owner of this lease or the manager for such owner shall accompany the remittance with a sworn statement of the amount produced during the next preceding month and the market price of the output, and a copy of any pipe or pipe lines or tank receipts, check or memoranda of amount paid out or into such lines or tanks. The books, accounts, receipts and discharges of all lines, pipe lines, and tanks and gas lines and gas pipes connected with the operations under this lease and pertaining to the production, transportation and marketing of the output shall be open to the examination and inspection at all times by the Commissioner of the General Land Office or his representatives, or any other representative of the State authorized by the Governor or Attorney General.

[fol. 21] 2. The value of any unpaid royalty or royalties and any sum or sums due the State upon this lease shall become a prior lien upon all production or natural gas produced upon the area leased to secure the payment of any royalties and sums due the State.

3. The owner of the rights herein conveyed shall proceed with reasonable diligence and in a bona fide effort to develop and to operate the area leased and to prosecute such drilling operations with due and reasonable diligence to the usual depth at which oil is found in other wells in the same vicinity, unless it is found in commercial quantities at a less depth: and to proceed with reasonable diligence and in a well during the life of this lease: and with due and reasonable diligence and in a bona fide effort, proceed, either voluntarily or when requested by the Commissioner of the General Land Office, to drill such other offset well or wells as may be necessary to protect such area leased from any well or wells that may be drilled on private land in the same vicinity and within such proximity as to render offset wells reasonably necessary for the protection of the interest herein.

4. The owner of the rights herein conveyed shall have the exclusive right during the life of this lease to drill for petroleum and gas on the area leased together with the right of way thereon for laying and the right to lay pipe lines to convey water, petroleum, steam or gas.

5. If any statement made by the owner of this lease which was necessary to the issuance thereof was false or untrue in [fol. 22] material matters, or should the owner hereof fail or refuse to proceed in good faith and with reasonable diligence and in a bona fide effort to develop, operate and put out the petroleum or gas at any time during the life of this lease or fail or refuse to make the proper remittance in payment for royalty or other payments, or fail or refuse to make the proper statement, or fail to furnish the required evidence of the out put and market value and other material matters relating thereto when requested, or should fail or refuse to comply with any other regulations adopted by the Commissioner of the General Land Office which are reasonably necessary for the proper execution of the provisions of the statutes relating to the subject matter herein, this lease shall be subject to forfeiture.

6. All operations in water shall be done, as far as practicable, in such manner as to prevent the pollution of such water.

7. Upon the abandonment of any well, it shall be securely plugged or closed by the owner so as to prevent the escape of salt water and the entrance of salt water or fresh water into oil or gas bearing formation.

8. All the terms and conditions herein shall extend to the heirs, successors and assigns of said lessee, if such heirs, successors or assigns are entitled, under the laws of the State of Texas, to hold the rights conveyed herein.

In testimony whereof witness the signature of the said J. H. Walker, Chf. Clerk and acting Commissioner of the General Land Office of the State of Texas, and seal of said office, this the 20th of May 1924.

[fol. 23] J. H. Walker, Chf. Clk. & Actg. Commissioner
General Land Office of Texas.

Filed May 22, 1924, at 2:50 o'clock P. M.

Recorded Vol. 4, page 551, Oil and Gas Records, Reagan County, Texas.

EXHIBIT B TO PETITION

Oil and Gas Lease No. 8607

General Land Office, Austin, Texas

July 14, 1924.

Whereas, the Commissioner of the General Land — of the State of Texas did issue the following permits to prospect for oil and gas under provisions of Chap. 83 Act approved March 16, 1917, on University Lands in Reagan County, viz:

Permit No. 3884 issued 7-7-19 to F. T. Pickrell on Secs. 3-4-9-10, Blk. 2;

Permit No. 3932 issued 7-8-19 to Frank Gordon on Secs. 15-16-21-22, Blk. 9;

Permit No. 3888 issued 7-7-19 to F. T. Pickrell on Secs. 29-30-31-32, Blk. 9;

Permit No. 3915 issued 7-8-19 to Elias G. Krupp on Secs. 1-2-11-12, Blk. 8,

Each of said Permits aggregating 2560 acres of land.

Whereas, the hereinbefore described Permits Nos. 3884, 3932, 3888 and 3915 were extended to a term of 5 years from their respective dates, under provisions of Chap. 6 Act approved Feby. 1, 1921.

Whereas, under provisions of Chap. 81, Act approved July 31, 1919, the said F. T. Pickrell and Frank Gordon did [fol. 24] by instrument dated Nov. 5, 1923, convey unto Elias G. Krupp all their right, title and interest in and to the hereinbefore described Permits Nos. 3884, 3888 and 3932, and in the same instrument of writing all of said permits, together with Permit No. 3915, which was already owned by said Elias G. Krupp, were grouped or combined for development purposes under provisions of said Chapter 81:

Whereas by deed dated Nov. 10, 1923, the said Elias G. Krupp, conveyed all his right, title and interest in and to said Permit No. 3884 to Edward C. Stearns, Pittsburgh, Pa., as evidenced by instrument filed in this office Dec. 4, 1923, and,

Whereas, by deed dated Nov. 16, 1923, the said Edward C. Stearns did transfer to the Big Lake Oil Co., all his right, title and interest in and to said Permit No. 3884, as evidenced by instrument filed in this office, Dec 4, 1923, and,

Whereas, it having been shown by instrument filed in this office, July 11, 1924, that oil was produced in commercial quantities on Sec. 1, Blk. 8, embraced in Permit 3915, and requesting that lease be issued, accompanying said request with log of well properly sworn to, and

Whereas, it appearing from the records of General Land Office that the law has been fully complied with in developing under said permits and in all things required before obtaining a lease: Now, Therefore, Know All Men By These Presents:

For and in consideration of the premises aforesaid and the obligations hereinafter named, the State of Texas, acting by and through J. T. Robison, Commissioner General [fol. 25] Land Office of said State, under the laws of said State, does hereby grant and lease unto the said Elias G. Krupp and Big Lake Oil Co. the area embraced in the hereinbefore described Permits Nos. 3884, 3915, 3888, 3932 as their respective interest may appear from the records hereinbefore set out in Chapter 81 Acts of 1919, for a term of 10 years, with right of renewal, or renewals, together with the right to enter upon said land at all times during the life of this lease for the purpose of mining, drilling and operating for petroleum or gas, and to erect and maintain all buildings, structures, fixtures, pipes, pipe lines and machinery necessary for the production, the storage and the transportation of petroleum or gas upon the following conditions, viz:

1. The owner of the rights herein conveyed shall pay to the State of Texas at General Land Office of Texas, Austin, Texas, a sum of money equal to a royalty of 1/8 of the value of the gross production of petroleum and shall pay a sum of money equal to 10% of the value of all gas sold. Payments of royalty shall be made monthly and on or before the 15th of each succeeding month during the life of this lease. Payments shall be made either in cash or by exchange on some Bank in Austin, Texas, or by Post Office money order or by Express money order. When payments are made the owner of this lease or the manager for such owner shall ac-

company the remittance with a sworn statement of the amount produced during the next preceding month and the market price of the output, and a copy of any pipe or pipe lines or tank receipt, check or memoranda of amount paid [fol. 26] out or into such lines or tanks. The books, accounts, receipts and discharges of all lines, pipe lines, and tanks and gas lines and gas pipes connected with the operation under this lease and pertaining to the production, transportation and marketing of the output shall be open to the examination and inspection at all times by the Commissioner of the General Land Office or his representatives, or any other representative of the State authorized by the Governor or Attorney General.

2. The value of any unpaid royalty or royalties and any sum of sums due to the State upon this lease shall become a prior lien upon all production or natural gas produced upon the area leased to secure the payment of any royalties and sums due the State.

3. The owner of the rights herein conveyed shall proceed with reasonable diligence and in a bona fide effort to develop and to operate the area leased and to prosecute such drilling operations with due and reasonable diligence to the usual depth at which oil is found in other wells in same vicinity, unless it is found in commercial quantities at a less depth; and proceed with reasonable diligence and in a bona fide effort to put out product of each producing well during the life of this lease; and with due and reasonable diligence and in a bona fide effort, proceed, either voluntarily or when requested by Commissioner General Land Office, to drill such other offset well or wells as may be necessary to protect such area leased from any well or wells that may be drilled on private land in the same vicinity and within such [fol. 27] proximity as to render offset wells reasonably necessary for the protection of the interests herein.

4. The owner of the rights herein conveyed shall have the exclusive right during the life of this lease to drill for petroleum and gas on the area leased together with the right of way thereon for laying and the right to lay pipe lines to convey water, petroleum, steam or gas.

5. If any statement made by the owner of this lease which was necessary to the issuance hereof was false or untrue in

material matters, or should the owner hereof fail or refuse to proceed in good faith and with reasonable diligence and in a bona fide effort to develop, operate and put out the petroleum or gas at any time during the life of this lease or fail or refuse to make the proper remittance in payment for royalty or other payments, or fail or refuse to make the proper statement, or fail to furnish the required evidence of the out put and market value and other material matters relating thereto when requested, or should fail or refuse to comply with any other regulations adopted by the Commissioner of the General Land Office which are reasonably necessary for the proper execution of the provisions of the statute relating to the subject matter herein, this lease shall be subject to forfeiture.

6. All operations in water shall be done, as far as practicable, in such manner as to prevent the pollution of such water.

7. Upon the abandonment of any well, it shall be securely plugged or closed by the owner so as to prevent the escape. [fol. 28] of salt water and the entrance of salt water or fresh water into oil or gas bearing formation.

8. All the terms and conditions herein shall extend to the heirs, successors and assigns of said lessee, if such heirs, successors or assigns are entitled, under the laws of the State of Texas, to hold the rights conveyed herein.

In testimony whereof, witness the signature of the said J. T. Robison, Commissioner of the General Land Office of the State of Texas, and seal of said office, this the 14th day of July, 1924.

J. T. Robison, Commissioner General Land Office of Texas. (Seal.)

Filed August 6, 1924, at 6:55 o'clock P. M. Recorded Vol. 5, Pages 188, Oil and Gas Records, Reagan Co. Texas

[File endorsement omitted.]

[fol. 29] IN UNITED STATES DISTRICT COURT

[Title omitted]

GENERAL DEMURRER AND ANSWER—Filed Oct. 19, 1929

Now comes James W. Bass, Collector of Internal Revenue, defendant in the above styled and numbered cause, and

demurs generally to the plaintiff's original petition filed herein on September 23, 1929, for the reason that the same does not state facts sufficient to constitute a cause of action against him, and of this he prays judgment of the Court.

John D. Hartman, United States Attorney, Attorney for Defendant.

Should the foregoing demurrer be overruled and this defendant be required to further answer herein then he denies all and singular the material allegations contained in the plaintiff's original petition, and of this he puts himself upon the country.

John D. Hartman, United States Attorney, Attorney for Defendant.

[File endorsement omitted.]

[fol. 30] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION WAIVING JURY—Filed Oct. 19, 1929

It is stipulated by and between the parties to this cause by their respective attorneys that a trial by jury is waived and all matters of fact shall be submitted to the Court.

Group No. 1 Oil Corporation, Plaintiff, by Homer L. Bruce, Its Attorneys. James W. Bass, Collector of Internal Revenue, Defendant, by John D. Hartman, U. S. Atty., His Attorney.

[File endorsement omitted.]

[fol. 31] IN UNITED STATES DISTRICT COURT

[Title omitted]

AGREED STATEMENT OF FACTS—Filed Oct. 19, 1929

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true, provided, however, that

this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

I

The allegations contained in Division I (one) of plaintiff's original petition are true.

II

The allegations contained in Division II (two) of plaintiff's original petition are true.

III

The allegations contained in Division III (three) of plaintiff's original petition are true, except that defendant does not admit the collection of the taxes was wrongful or illegal or without authority of law.

[fol. 32]

IV

The allegations contained in Division IV (four) of plaintiff's original petition are true.

V

The allegations contained in Division V (five) of plaintiff's original petition are true. In connection with the installment of $3,398.74 taxes paid by plaintiff on March 18, 1929, it may be considered that plaintiff duly filed a claim for the refund of that amount similar to the claim filed by it for the refund of the other installments of taxes for the same year; that such claim was so filed more than six months before this cause was begun; that no decision thereon has been rendered by the Commissioner of Internal Revenue; and that plaintiff's petition asks for the recovery of said installment on the same grounds as the other installments for said year.

VI

The copies of the leases referred to in Division VI (six) of said petition, and attached thereto as Exhibits A and B,

are true copies of the original leases. The plaintiff has been the owner of each of said leases in so far as they covered Section 36 of Block 9 and Section 1 of Block 8, referred to in said Division VI, at all times since they were issued by the State of Texas, and plaintiff's said petition may be considered as alleging this fact.

It is the desire of both plaintiff and defendant to eliminate in this cause every issue affecting plaintiff's Federal [fol. 33] income taxes for the years herein involved, except the single question of exemption asserted by plaintiff. It is recognized that, even if plaintiff's contentions concerning exemption are sustained, there would remain undetermined questions as to what items of other income are taxable, and what items of expenditures are deductible, which questions cannot be adjudicated in this suit. In said Division VI of the petition there are set forth certain items of income admitted by plaintiff to be taxable, and certain items of expenditures claimed by plaintiff to be proper deductions as against said taxable income. The defendant does not agree to the correctness of these items. However, both parties hereto recognize that any items of income included in plaintiff's said returns that would be taxable in the event plaintiff's contentions for exemption for its income from said oil and gas leases are sustained, would be less than plaintiff's expenditures properly deductible against said taxable income, and in view of this, that it is unnecessary for the Court in this case to determine, if it sustains plaintiff's contentions concerning said exemption, what items of expenditures are properly deductible as against plaintiff's taxable income, and accordingly it is further agreed in reference to the allegations contained in said Division VI (six):

1. All of the income of plaintiff included in its returns for the periods involved in this cause was derived from the sale of oil and gas produced by it from said Sections 36 and 1 under the hereinbefore mentioned oil and gas leases from the State of Texas, except dividends and those items of income admitted by it in said Division VI to be [fol. 34] derived from other sources. The income taxes sued for by plaintiff were assessed against, and paid by,

it on its said income derived from the sale of said oil and gas. If plaintiff is entitled to recover any part of the taxes sued for, it is entitled to recover all of them.

2. As against any of the income of plaintiff included in its said returns that is not included in its income derived from the sale of oil and gas produced by it under said leases from the State of Texas, plaintiff is entitled to deduct therefrom expenses incurred by it and included in its said returns amounting to more than said outside income, and none of the taxes sued for were assessed or paid because of said outside income. The defendant does not admit that any particular deduction claimed by plaintiff as properly deductible from said taxable income is a proper deduction. In view of the agreement contained in this division, it is unnecessary for the Court to pass upon those items; and the final judgment in this case shall not be considered in any other case as determining which, if any, of said claimed deductions are proper deductions against plaintiff's taxable income, or on the other hand, which of said item- of income that plaintiff admits are taxable, are in fact taxable.

3. A field agent of the United States Bureau of Internal Revenue has audited plaintiff's books and has filed with the Internal Revenue Agent in Charge at Dallas, Texas, a report recommending the assessment of additional income taxes against plaintiff. Further action on said report has been suspended for the present, and the defendant, because of said situation, is not asserting herein any claim against [fol. 35] plaintiff because of said proposed additional assessment. Accordingly, if the final decree in this cause should be in favor of the plaintiff, such decree shall not bar the defendant or the United States from collecting any additional taxes upon any income, if any, of plaintiff, not reported in its said returns that may be properly assessed, on the ground that defendant did not in this cause assert plaintiff's liability therefor. Likewise, if the final decree in this cause should be in favor of the defendant, such decree shall not bar the defendant or the United States from collecting any additional taxes upon plaintiff's income included in its said returns, or not, that may be properly assessed, on the ground that defendant did not assert in this cause plaintiff's liability therefor.

VII

The allegations contained in Division VII (seven) of plaintiff's original petition are true.

VIII

The allegations contained in Division VIII (eight) of plaintiff's original petition are true.

IX

The defendant does not admit the allegations contained in Division IX (nine) of plaintiff's original petition, but denies the same, pages 10 to 15 Orig. Petition.

X

The allegations contained in Division X (ten) of plaintiff's original petition are true.

[fol. 36]

XI

The allegations contained in Division XI (eleven) of plaintiff's original petition are true.

XII

In connection with the allegations contained in Division XII (twelve) of plaintiff's original petition, it is admitted that the defendant has been duly requested to refund the income taxes sued for by plaintiff, and he has refused to refund them to plaintiff. Defendant does not admit that the collection of said taxes was wrongful, illegal, or without authority of law. Defendant does not admit that any of said income taxes are due to plaintiff.

Signed in duplicate, each copy of which may be used as an orig-nal, this 9th day of October, 1929.

Homer L. Bruce, Attorney for Plaintiff, Group No. 1 Oil Corporation. John D. Hartman, United States District Attorney for the Western Division of Texas, Attorney for Defendant.

[File endorsement omitted.]

[fol. 37] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION FOR JUDGMENT IN FAVOR OF DEFENDANT—Filed Oct. 19, 1929

To the Honorable Judge of said Court:

Now comes James W. Bass, Collector of Internal Revenue, defendant in the above styled and numbered suit, and at the close of all of the testimony for both the plaintiff and the defendant moves the Court for a judgment in his favor for the reason that the facts are not sufficient to constitute a cause of action against him.

James W. Bass, Collector of Internal Revenue, Defendant, by John D. Hartman, U. S. Attorney.

[File endorsement omitted.]

[fol. 38] IN UNITED STATES DISTRICT COURT

[Title omitted]

PLAINTIFF'S MOTION FOR JUDGMENT—Filed Oct. 22, 1929

Comes now the plaintiff Group No. 1 Oil Corporation after close of the testimony and before the court has decided or announced his decision herein and before the entry of final judgment herein and moves the court to enter judgment in favor of the plaintiff and against the defendant for the amount sued for by the plaintiff and interest as sued for by the plaintiff and its costs herein incurred because under the pleadings, the evidence and the undisputed facts plaintiff is entitled to the judgment against the defendant for the full amount sued for and interest as sued for and all of its costs herein incurred.

Homer L. Bruce, Baker, Botts, Parker & Garwood, by Homer L. Bruce, Attorneys for Plaintiff.

Dated October 19, 1929.

[File endorsement omitted.]

[fol. 39] IN UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS, AUSTIN DIVISION

No. 1176. At Law

GROUP NO. 1 OIL CORPORATION, Plaintiff,

vs.

JAMES W. BASS, United States Collector of Internal Revenue, Defendant

MEMORANDUM OPINION—Filed Feb. 19, 1930

The submission of the case is on its merits, an agreed statement of facts and waiver of jury. Plaintiff sues for refund of taxes as unlawfully collected because assessed on incomes received arising from instruments styled "Oil and Gas Leases" executed by the State of Texas, lessor, to the plaintiff, of certain described lands belonging to the State of Texas and the University of Texas, by the terms of which plaintiff acquired all of the oil and gas to be produced, the State to receive therefor a consideration in cash of an amount equal to the value of one-eighth of the gross quantity of oil produced, and an amount equal to the value of one-tenth of gas produced and sold. Plaintiff's net income from these two sources for the years 1925, 1926, 1927 and 1928 was taxed by the United States and the amount $733,397.51 paid.

The questions presented are whether or not the net incomes realized by plaintiff lessee from oil and gas produced on lands belonging to the State and University of Texas [fol. 40] are (1) exempt from taxation by the United States by the terms of the State annexation compact between the Republic of Texas and the United States, or (2) lawfully taxable by the terms of the Constitution of the United States.

Upon the close of the admission of evidence at the trial each party moved for judgment. The material facts being admitted, the disputed issues are those of law. The instruments are "Oil and Gas Leases," respectively, "No. 856" and "No. 8607," copies of which are attached to the original petition as Exhibits "A" and "B."

The truth of allegations of fact in plaintiff's original petition is conceded by stipulation, except immaterial mat-

ters in Paragraph Nine, and in other immaterial particulars.

The leases are executed by the State, through the Commissioner of the General Land Office, to plaintiff's assignors. Some of the provisions, in brief, are: "* * * does hereby grant and lease * * *" for 10 years, with right to enter upon said land at all times during the life of the lease for the purpose of mining, drilling and operating for petroleum or gas, to erect buildings, pipe-lines, storage, on condition:

"(1) The owner of the rights herein conveyed shall pay to the State of Texas * * * a sum of money equal to a royalty of one-eighth of the value of the gross production of petroleum and shall pay a sum of money equal to 10 per cent of the value of all gas sold. * * *

(2) The value of any unpaid royalty or royalties and any sum or sums due the State * * *" are a prior lien on all production.

(3) Reasonable diligence is required in drilling and de- [fol. 41] veloping, with "bona fide effort to put out the produce of each producing well during the life of this lease, * * *" to drill offset wells.

"(4) The owner of rights herein conveyed shall have the exclusive right * * *" to drill during the life of the lease and also right-of-way to lay pipe-lines.

(5) The owner of the lease, upon failure to perform enumerated requirements or to comply with any regulations adopted by the Commissioner of the General Land Office, will subject the lease to forfeiture.

"(6) * * *
(7) * * *"

(8) All terms and conditions shall extend "to the heirs, successors and assigns" of the lessee. The leases are signed by the Acting Commissioner of the General Land Office of Texas, with seal.

The lands leased first acquired status as property as being part of the domain of the King of Spain; then by succession passed to the Republic of Mexico; thence to the Republic of Texas; and, finally to the State of Texas and

the University of Texas. The vacant and unappropriated lands of the Republic were conceded by the United States, in the admission compact with the Republic of Texas, as vested in the State of Texas, "to be disposed of as said State may direct."

Plaintiff's claims for refund are: That the lands leased were originally acquired and held by the Republic of Texas in its sovereign capacity; and that by the treaty compact with the United States the right of the State of Texas to dispose of such lands was ceded without condition, other than that the United States should not be held for any [fol. 42] debts or liabilities of the Republic. Therefore, to tax the lands or the proceeds derived from their sale or lease would be to burden and hinder the State in the exercise of its treaty right to dispose of its lands as it might direct. Likewise a tax imposed on the incomes of plaintiff lessee derived therefrom, being the means and instrumentalities used by the State of Texas in the exercise of its unlimited right of disposal of its lands, would burden, impair, hinder, limit and destroy such right.

The defendant contends: That only strictly governmental activities of a state are immune from Federal taxation; that in this case neither the development of oil and gas by the State, nor the maintenance by the State of its University, are strictly governmental activities. Therefore, plaintiff's incomes, being profits made in disposing of oil purchased from the State, are subject to the Federal tax assessed and collected.

The ability and industry of counsel have exhausted all sources of authority. The issues are narrowed to essentials. Stated in question form, they are:

First. What is the effect of the treaty guarantee on the right of the State of Texas to dispose of the lands of the Republic of Texas?

Second. Are the so-called leases, and the plaintiff lessee-purchaser, the means and instrumentalities used by the State to develop its land for the State and its University?

Third. Is the maintenance by the State of its University a strictly governmental activity?

[fol. 43] Fourth. Do the taxes on the incomes derived by plaintiff as lessee-purchaser of State lands, being the

State's means and instrumentality, impair and abridge the State's right to dispose of its lands?

* * * * * * *

First. Question Answered: The State of Texas came into being through resolutions of the Congress of the United States and the Convention of the Republic of Texas, the Republic thus becoming a state. The resolutions are found in 5 U. S. Statutes 797; 9 U. S. Statutes 108; Gammel's Laws of Texas, Vol. 2, pages 1200, 1225 and 1228. The specific guarantee to the State is as follows:

"2. And be it further resolved, that the foregoing consent of Congress is given upon the following conditions, and with the following guarantees, to-wit:

"Second. Said State * * * shall also retain all the vacant and unappropriated lands lying within its limits, to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after discharging said debts and liabilities, to be disposed of as said State may direct; but in no event are said debts and liabilities to become a charge upon the Government of the United States."

No issue of fact is in the record to indicate the existence of any debts or liabilities of the Republic of Texas. It is therefore assumed that the State is granted the right to dispose of its landed domain as it "may direct." The Legislature of the State, by mandate of the Constitution, was directed to establish and provide for the support and [fol. 44] maintenance of the University of Texas. See State Constitution 1876, Art. 7, Secs. 10 to 15, inclusive. One million acres of land, in addition to previous grants, were set apart for the support of the University.

The Legislature passed laws concerning the disposal of the University lands. The act providing terms under which permits, leases and sales could be made appeared in Chapter 83 of Acts of the Thirty-fifth Legislature, March 16, 1917, and is still effective. It applies to the methods used in this case.

Pursuant to the treaty grant, the State, through its fundamental law, directed that a million acres of land be set apart by the Legislature for the support of the University.

They were so set apart. Acting through its Legislature, the State directed that the oil and gas underlying its University lands be developed by means of sales of oil in place, to be paid for only when reduced to possession by capture, or, in the words of the lease, when "produced." The right so to dispose of these essential elements of land through the means employed is included by the words of the treaty compact. There is no room for construction or interpretation of the words conferring unlimited right to dispose. They are clear and all-embracing and should be given effect. The right being without limitation, none can be placed by the United States on the means and instrumentalities used by the State in disposing of its lands.

The Court holds that the effect of the treaty compact is: That the State could dispose of its lands in the exercise of a strictly governmental activity or otherwise as it might [fol. 45] direct; and therefore the United States has no power to impede or hinder the means and instrumentalities used by the State in exercising its unlimited right of disposal.

Second. Question Answered: The method used by the State to develop the oil and gas on its University lands here being developed was to make the lease-purchase contracts with plaintiff, the incomes resulting therefrom to plaintiff being taxed, collected and sued for herein. It is common knowledge that search for oil and gas is highly speculative. Oil drilling requires the employment of specialists, geologists, chemists, machinists, and the like. Oil when found must be "produced" at the well's mouth and sold there or at a distance, by transport in tank cars or pipe-lines, to refineries, or to world markets. A state might embark in the business of producing oil, but to do so would be unusual. The oil-lease method of development by land-owners is customary.

Accordingly, the Court holds that the State of Texas in the exercise of a common sense judgment, selected plaintiff, by the lease contracts in evidence, as the means through which to explore and develop the oil and gas underlying its University lands. This character of contract is considered by authority as being legitimate "means and instrumentalities" when used by the United States and the States in like development. Choctaw, Okla., Gulf Railroad v. Har-

rison, 235 U. S. 292; Indian Territory Illuminating Oil Co. v. Okla., 240 U. S. 522; Gillespie v. Okla., 257 U. S. 501; Jaybird Mining Co. v. Wier, 271 U. S. 609; Metcalf v. Mitchell, 269 U. S. 523-524.

[fol. 46] Third. Question Answered: The rule of the common law that it is the duty of the parents to educate the child, if considered as in effect at the time of the adoption of the Constitution of the United States has generally been supplemented by constitutional and statutory enactments in the several states which recognize that education is one of the functions of government, and the public school system is now a department of the government. "The primary purpose of the maintenance of the common school system is the promotion of the general intelligence of the people constituting the body politic, and thereby to increase the usefulness and efficiency of the citizens, on which the government of society depends." 24 R. C. L. 558. Education as a governmental activity is exercised by the Federal government to a limited extent. The States generally have by statutes assumed the public education of its citizens. This has become so uniformly widespread as to warrant the conclusion that public education as a governmental function was not included in the constitutional grant of powers to the Federal government, but was reserved to the sovereign states.

South Carolina vs. United States, 199 U. S. 437, declares that strictly governmental activities must be classified by recourse to the common law in interpreting the Constitution and "also to the position of the framers of the instrument, and what they must have understood to be the meaning and scope of the grants of power contained therein." The expression is of doubtful application to the facts of this case.

[fol. 47] Texas was admitted to the Union in 1845, fifty-five years after the adoption of the Federal Constitution, and unlike other states, retained its unappropriated public domain with unlimited right of disposal. Plaintiff and the lease contracts are the means used by the State to dispose of its lands.

In South Carolina v. United States, the issues were whether engaging in the business of dispensing liquor by the State was a private business or the exercise of a strictly

governmental activity, and whether the National government's power to impose license taxes on the private business of that character applied where the State was conducting such business. The question here is whether or not public education became a strictly governmental activity by virtue of statutes of the Republic in effect at the time that Texas was admitted to the Union, and the constitutional and legislative enactment since.

The congress of the Republic of Texas, in the exercise of the governmental function, passed an act of date January 6, 1839 (2 Gammel's Laws of Texas 134) directing the President to set aside 50 leagues of land to establish two colleges thereafter to be created. Texas came into the Union in December, 1845, and passed an act February 11, 1858, (4 Gammel's Laws of Texas 1020), establishing the University of Texas, appropriating $100,000.00 therefor, and setting aside additional lands for the purpose. This act recites that it had been the fixed design of the people of the Republic and of the State that there should be established an institution for the instruction of the youth of [fol. 48] the land, to be so endowed as to be within the reach of rich or poor a thorough education, as a means to attach young men to the institutions of the State, and that the liberties of the people might be encouraged. The State Constitution of 1876, directed the Legislature to provide for the maintenance of the University of Texas. Pursuant thereto, the present University of Texas was created, March 30, 1881, (9 Gammel's Laws of Texas 171), to be governed by eight regents nominated by the Governor and appointed by and with the advice of the Senate, the government of the University being subject at all times to the control of the Legislature. The University is not a corporation. Its affairs are directed and controlled exclusively by the State. The title to what is commonly called University lands is in the State. Appropriations for maintenance and operation are regularly made by the Legislature. The University is in fact and in law a branch of the State government. See cases cited in 24 Ruling Case Law, supra.

The authorities give no clear definition of "governmental activities," nor the degree of strictness required.

The courts determine the question from the facts in the particular cases. No principle of the common law effective at the time of the adoption of the Constitution in 1791 is cited as holding that public education is or is not a strictly governmental activity. South Carolina was conducting a private business, buying and selling liquor, therefore liable for the taxes levied. Lacking law or facts as of the effective period, the statutes of the states supersede the common law, if any, and should control. It is common knowl-[fol. 49] edge that the states, by constitutional and legislative enactments and appropriations, are educating their people—unquestionably governmental activities, but are they "strictly" so? Education is not bought and sold like physical commodities. It is fair to say that public education by the states is the rule and private education the exception. A principle of construction that the sovereign states could in future exercise only such sovereign rights as were known to the common law, or the law of nations, at the time of the adoption of the Constitution, means a rigidity out of harmony with judicial expressions to the effect that our Constitution is flexible and continues to meet and adjust itself to the new and rapidly changing conditions.

Important facts worthy of repeating are that public education was in the minds of the fathers of the Republic of Texas in January, 1839, when the President was directed by the Congress to set aside 50 leagues of land to establish public colleges. Lands and funds were appropriated by the Legislature of the State of Texas in 1858. A million acres were set apart by constitutional mandate in 1876 for the benefit of the University, established by the Legislature in 1881, and continued maintenance since.

The facts here differ in material particulars from those in South Carolina v. United States. The rule that strictly governmental activities may be ascertained only in the light of conditions of law and fact existing at the time of the adoption of the Constitution are not applicable to the case at bar.

Accordingly, the Court holds, that since 1839 the Re-[fol. 50] public and the State of Texas evidenced an earnest intention by appropriations of lands and funds, to adopt education as a governmental policy; and that since

1881, by the constitutional mandate and legislative enactment, the State, through its University and public schools, has undertaken the education of its peoples as a strictly governmental activity.

Fourth. Question Answered: This question is answered in the affirmative by the cases cited in support of the reply to Question Two.

The defendant contends that there is no evidence in the record to show that either the State or University would suffer any injury by the tax levy. After reviewing all the decisions of the Supreme Court bearing on the Indian lease contracts and Oklahoma's attempt to levy a tax on a lessee's income in Gillespie v. Oklahoma, 506, supra, the opinion closes with the following statement: "Whether this property could be taxed in any other form or not, it cannot be reached as profits or income from leases such as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the efforts of the United States to make the best terms for its wards"—citing Weston v. Charleston, 27 U. S. 448 (1829), Marshall, Chief Justice.

The cases hold that a tax imposed upon incomes from a lease of the character in evidence is a direct hamper on the efforts of the lessor sovereign to make the best terms [fol. 51] for itself or its beneficiary. The Court finds that there is evidence in the record to give application to the principle declared. A careful study of the cases cited, and those cited in the opinions rendered, is convincing that all principles of law arising from the facts in this case have been considered.

The plaintiff relies on Gillespie v. Oklahoma, supra, as authority directly in point and of controlling weight as to the law. The defendant argues that South Carolina v. United States, supra, controls because that case declares that states that engage in private business are subject to the Federal excise tax, and that only strictly governmental activities are free from Federal tax. In ruling that the maintenance of its State University was strictly a governmental activity, and therefore free of the tax, the Court has stated the reasons upon which they are based.

From the foregoing it results that the plaintiff is entitled to the refund of taxes, collected by the defendant in the amounts sued for. Form of judgment in accordance may be submitted for entry within ten days from date hereof. A list of cases considered is appended as a foot note.

Done at Austin, Texas, this 19th day of February, A. D., 1930.

Duval West, Judge.

[fol. 52] Cases Considered

Ambrosini v. United States, 187 U. S. 1;
Bank of Commerce v. New York City, 67 U. S. (2 Black) 620;
Bank Tax Case, 69 U. S. (2 Wall.) 200;
Childers v. Beaver, 270 U. S. 555;
Choctaw, Okla. & Gulf R'y Co. v. Harrison, 235 U. S. 292;
Collector v. Day, 78 U. S. (11 Wall.) 113;
Dobbins v. Commissioners of Erie County, 41 U. S. (16 Peters) 434;
Farmers & Mech. Nat'l Bank v. Dearing, 91 U. S. 29;
Flint v. Stone Tracy Company, 220 U. S. 107;
Gillespie v. Oklahoma, 257 U. S. 501;
Grayburg Oil Co. v. State of Texas, Sup. Ct. Rep. Vol. 49, Pg. 185;
Heiner v. Colonial Trust Co., 275 U. S. 232;
Howard v. Gypsy Oil Co., 247 U. S. 503;
Indian Territory Illum. Oil Co. v. Oklahoma, 240 U. S. 522;
Jaybird Mining Co. v. Weir, 271 U. S. 609;
Johnson v. Maryland, 254 U. S. 51;
Large Oil Company v. Howard, 248 U. S. 549;
Long v. Rockwood, 277 U. S. 142;
Metcalf & Eddy v. Mitchell, 269 U. S. 514;
M'Culloch v. The State of Maryland, 4 Wheat 316;
Northwestern Mut. Life Ins. Co. v. Wisconsin, 275 U. S. 136;
Osborne v. The Bank, 9 Wheat. 737;
Panhandle Oil Co. v. Knox, 277 U. S. 218;
[fol. 53] Pollock v. Farmers Loan & Trust Co., 157 U. S. 429;
Shaw v. Gibson-Zahniser Oil Corp., 276 U. S. 575;
South Carolina v. United States, 199 U. S. 437;

Van Brocklin v. Tennessee, 117 U. S. 151;
Weston v. City Council of Charleston, 27 U. S. (2 Peters) 448;
Williams v. City of Talladega, 226 U. S. 404;
Burnes National Bank v. Duncan, 265 U. S. 17;
California v. Central Pacific Ry. Co., 127 U. S. 1;
Thomson v. Pacific R. R., 9 Wall, 579;
Railroad Company v. Peniston, 18 Wall. 5;
United States v. Perkins, 163 U. S. 625;
Plummer v. Coler, 178 U. S. 115;
Veazie Bank v. Fenno, 8 Wall. 533;
Snyder v. Bettman, 190 U. S. 249;
Theisén v. Robison, 8 S. W. (2d) 646;
Bank of North Dakota v. Olson, 33 Fed. (2d) 848;
Davis v. Gray, 83 U. S. (16 Wall.) 203;
United States v. Rickert, 188 U. S. 432.

[File endorsement omitted.]

[fol. 54] In United States District Court for the Western District of Texas, Austin Division

No. 1176. At Law

Group No. 1 Oil Corporation, Plaintiff,

vs.

James W. Bass, United States Collector of Internal Revenue, Defendant

Decree—Filed Feb. 28, 1930

Be it remembered that on the 19th day of October, 1929, came on to be heard the above numbered and entitled cause, and came the plaintiff Group No. 1 Oil Corporation by its attorneys and the defendant James W. Bass, United States Collector of Internal Revenue, by his attorneys, and all parties announced ready for trial. A jury having been expressly waived in writing, the matters of law and of fact were submitted to the court. The court having heard and considered the pleadings, evidence and argument of counsel is of the opinion and does now on this 28th day of February,

1930, order, adjudge and decree that the plaintiff Group No. 1 Oil Corporation do have and recover judgment against the defendant James W. Bass, United States Collector of Internal Revenue for the First Internal Revenue District of Texas, for the sum of Seven Hundred Thirty six Thousand Seven Hundred Ninety Six and 25/100 Dollars ($736,796.25), together with interest thereon at the rate of six per cent (6%) per annum, said interest to be computed from the various dates the installments representing said [fol. 55] aggregate amount were paid by the plaintiff to the defendant, said installments being as follows and the dates from which the said interest is to be recovered being set opposite each installment, to-wit:

November 16, 1925	$5,000.00
December 11, 1925	4,882.55
March 9, 1926	4,941.27
June 9, 1926	4,941.27
April 28, 1926	395.31
June 11, 1926	115,308.87
September 15, 1926	115,308.87
December 14, 1926	115,308.87
March 18, 1927	115,308.87
June 16, 1927	60,545.46
September 15, 1927	60,546.12
December 16, 1927	60,545.79
March 20, 1928	60,545.79
June 15, 1928	3,398.71
September 11, 1928	3,398.70
December 15, 1928	3,021.06
March 18, 1929	3,398.74

It is further ordered, adjudged and decreed that all process necessary and appropriate for the enforcement of this judgment issue.

To which judgment the defendant in open court excepted and upon his application, the court allowed and the defendant is hereby granted sixty (60) days after adjournment of the present Austin term of court within which to settle and file bills of exceptions and do all other things and procure [fol. 56] proper orders for completion of the record for effective appeal from this judgment.

Duval West, United States District Judge.

Approved:
Homer L. Bruce, Attorney for Plaintiff. John D. Hartman, U. S. Attorney.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

[Title omitted]

Bill of Exceptions and Order Settling Same—Filed April 1, 1930

Before Honorable Duval West, United States District Judge, Without a Jury

Be it remembered that this action was commenced in the United States District Court for the Western District of [fol. 57] Texas in the Austin Division thereof, by the plaintiff's petition filed September 23, 1929; that thereafter on October 19, 1929 the defendant filed a general demurrer and general denial; that on October 19, 1929 written stipulations were entered into by the parties to this suit waiving a trial by jury. That on October 19, 1929 an agreed statement of facts was filed herein. That on the 19th day of October, 1929 all matters of law and fact were submitted to the Court, after which and before judgment was entered, on October 19, 1929 the defendant at the close of all of the testimony moved the Court for a judgment in his favor for the reason that the facts were not sufficient to constitute a cause of action against him. That thereafter on October 22, 1929 the plaintiff filed a motion before the entry of judgment, moving the Court to enter judgment in favor of the plaintiff and against the defendant for the amount sued for by the plaintiff because of the pleadings, the evidence and the undisputed facts the plaintiff is entitled to judgment. That thereafter the Court took the matter under advisement and filed a memorandum opinion on February 19, 1930, in substance and effect holding that the plaintiff under the pleadings and the evidence was entitled to recover the full amount sued for, and directing that a judgment be prepared and entered in accordance with said opinion.

That thereafter, to wit, on the 28th day of February 1930, a judgment was filed in accordance with the opinion of the Court, to which judgment the defendant in open court excepted, and the Court allowed the defendant sixty days after the adjournment of the present Austin term of Court [fol. 58] within which to settle and file bills of exception and do all other things and procure proper orders for completion of the record for effective appeal from this judgment. That the effect of the Court's opinion was to overrule the defendant's general demurrer filed herein and to overrule the defendant's motion for a judgment filed herein as above indicated, to all of which the defendant now excepts and tenders this as his bill of exceptions.

And now in furtherance of justice and that right may be done to the defendant, the defendant tenders and presents the foregoing as his bill of exceptions in this cause to the action of the Court and prays that the same may be settled and allowed and signed and sealed by the Court and made part of the record in this cause.

Dated at San Antonio, Texas, on this the 1st day of April, A. D. 1930.

John D. Hartman, United States Attorney, Attorney for Defendant.

The above and foregoing Bill of Exceptions is hereby settled and allowed and ordered filed as part of the record in this cause.

Dated at San Antonio, Texas, this the 1st day of April, A. D. 1930.

Duval West, United States District Judge.

[File endorsement omitted.]

[fol. 59] In United States District Court

[Title omitted]

Defendant's Petition for Appeal—Filed April 1, 1930

Now comes James W. Bass, Collector of Internal Revenue, defendant in the above styled and numbered cause, and says that on or about the 28th day of February, A. D. 1930, this Court entered judgment in favor of the plaintiff,

Group No. 1 Oil Corporation, and against the defendant, James W. Bass, Collector of Internal Revenue, in which judgment and proceedings prior thereto in this cause certain errors were committed to the prejudice of the defendant, all of which will more in detail appear from the Assignments of Error which are filed with this petition; that this judgment is to all intents and purposes a judgment against the United States.

Wherefore, premises considered, the defendant prays that an order be issued by the Court allowing an appeal to the United States Circuit Court of Appeals for the Fifth Circuit, for the correction of the errors complained of, and that a transcript of the record, proceedings and papers in this cause duly authenticated may be sent to the said Circuit Court of Appeals, and that an order be made to the effect [fol. 60] that this appeal may be prosecuted without supersedes or cost bond and that all further proceedings may be suspended until the determination of said Writ of Error by said Circuit Court of Appeals.

John D. Hartman, United States Attorney, Attorney for the Defendant.

[File endorsement omitted.]

ASSIGNMENT OF ERRORS—Filed April 1, 1930

Now comes the defendant in the above styled and numbered cause and hereby makes the following Assignments [fol. 61] of Error which he avers occurred upon the trial and the proceedings in said cause, to wit:

1. The Court erred in not sustaining the defendant's general demurrer to the plaintiff's original petition.

2. The Court erred in not sustaining the defendant's motion for a judgment in his favor made at the close of the testimony.

3. The Court erred in rendering judgment for the plaintiff for the reason that the law and the facts are not sufficient to sustain such judgment.

Dated this the 1st day of April, A. D. 1930.

John D. Hartman, United States Attorney, Attorney for Defendant.

[File endorsement omitted.]

[fol. 62] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER ALLOWING APPEAL WITHOUT BOND—Filed April 1, 1930

On this the 1st day of April, A. D. 1930, came the defendant, James W. Bass, Collector of Internal Revenue, and filed herein and presented to the Court his petition praying for the allowance of an appeal, and the defendant filed Assignments of Error intended to be urged by him and praying that a transcript of the record and proceedings and papers upon which the judgment herein was entered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Fifth Circuit, and that such other and further proceedings may be had as may be proper in the premises; and

The defendant further praying that neither supersedes nor cost bond be required for the reason that the judgment entered herein is to all intents and purposes a judgment against the United States;

It is, therefore, ordered by the Court that the defendant, James W. Bass, Collector of Internal Revenue, be and is [fol. 63] hereby allowed an appeal as prayed for without bond.

It is further ordered that further proceedings in this cause be suspended until the determination of said appeal by the Circuit Court of Appeals for the Fifth Circuit.

Duval West, United States District Judge.

[File endorsement omitted.]

[fol. 64] Citation, in usual form, showing service on Baker, Botts, Parker & Garwood, filed April 1, 1930, omitted in printing.

[fol. 65] IN UNITED STATES DISTRICT COURT

[Title omitted]

PRÆCIPE FOR RECORD—Filed April 1, 1930

To the Honorable D. H. Hart, Clerk U. S. District Court, Western District of Texas:

You will please include in the record upon appeal in the above entitled cause the following documents and proceedings:

1. Plaintiff's Original Petition.
2. Defendant's General Demurrer and Answer.
3. Stipulations Waiving a Jury.
4. Agreed Statement of Facts.
5. Defendant's Motion for Judgment in his favor.
6. Plaintiff's Motion for a Judgment in its favor.
7. The Court's Memorandum Opinion.
8. Judgment of the Court.
9. Defendant's Bill of Exceptions.
10. Defendant's Assignments of Error.
11. Petition for Appeal.
12. Order allowing Appeal without bond.

[fol. 66] 13. Appeal.
14. Citation on Appeal.
15. Acceptance of Service of Citation.
16. Præcipe for Record.
17. Clerk's Certificate.

John D. Hartman, United States Attorney, Attorney for Defendant.

[File endorsement omitted.]

[fol. 67] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 68] IN UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

CERTIFIED COPY OF HOUSE BILL NO. 812, STATE OF TEXAS—Filed April 22, 1930

A Bill to be Entitled

An Act to amend Article 7504, Revised Civil Statutes of 1911, by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.

Be it enacted by the Legislature of the State of Texas:

Section 1. That Article 7504, Revised Civil Statutes of the State of Texas, be amended so as to hereafter read as follows:

Art. 7504. Real property for the purpose of taxation shall be construed to include the land itself, whether laid out in town lots or otherwise, and all the buildings, structures and improvements, and other fixtures of whatsoever kind thereon, and all the rights and privileges belonging or in any wise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same, also all lease-hold interests whereby the lessee, grantee or licensee is authorized to mine and prospect for and take from lands, stone, granite, marble, fossils, minerals of any kind, including oil and gas.

Sec. 2. The fact that the right of the state to tax lease-hold interests in lands under which the lessee, grantee or licensee is permitted to prospect for and mine or take from said lands minerals, including oil and gas, is being disputed by the owners of said lease-hold interests, and the state [fol. 69] is being forced to have litigation with such persons, therefore the necessity to render the law of this state upon said subject beyond cavil or the possibility of a doubt, creates an emergency and an imperative public necessity requiring that the constitutional rule requiring bills to be read on three several days in both Houses be suspended,

and it is accordingly so done, and that this act be in force and take effect from and after its passage, and it is so enacted.

Floor Report

Committee Room, Austin, Texas

March 19, 1913.

Hon. Chester H. Terrell, Speaker of the House of Representatives.

Sir: Your Committee on Revenue and Taxation, to whom was referred House Bill No. 812, a bill to be entitled, An Act to amend Article 7504, Revised Civil Statutes of 1911, by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land, authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.

Have had the same under consideration, and I am instructed to report it back to the House with the recommendation that it do pass.

Mangum, Chairman.
Kirby.
Spradley.
Burges.
(For the purpose of getting before the House only.)
Roach.
Lane.

[fol. 70]

Dove.
Kennedy.
Patton.
Davis.
King.
Powell.
Diffie.

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[fol. 71] [Endorsed:] H. B. 812. By Kennedy. A bill to be entitled An Act to amend Article 7504, Revised Civil Statutes of 1911, by making clear the purpose and intent of the law to tax certain character of leasehold interests in land authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency. 318, 1913. Read first time and referred to Committee on Revenue & Taxation. Terrell. Favorable Floor Report. 3-19-13. (7)-Z.

[fol. 72] Form No. 7

(Seal of the State of Texas)

The State of Texas, Department of State

I, Jane Y. McCallum, Secretary of State, of the State of Texas, do hereby certify that the foregoing is a true and correct copy of House Bill No. 812, Introduced at the 33rd Legislature; and the report attached thereto, with the endorsement thereon, as now appears of record in this Department.

In Testimony Whereof I have hereunto signed my name officially and caused to be impressed hereon the Seal of State at my office in the City of Austin, this 10 day of April A. D. 1930.

(Signed) Jane Y. McCallum, Secretary of State.
(Seal.)

Form 860B—G57-320-10M.

[fol. 73] Minute entry of argument and submission April 22, 1930, omitted in printing.

[fol. 74] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 5881

JAMES W. BASS, Collector of Internal Revenue for the United States for the First District of Texas, Appellant,

versus

GROUP No. 1 OIL CORPORATION, Appellee

Appeal from the District Court of the United States for the Western District of Texas

John D. Hartman, U. S. Atty., Ottamar Hamele, Special Atty. Bur. Int. Rev. (C. M. Charest, Genl. Counsel, Bur. Int. Rev. on the brief), for Appellant.

Homer L. Bruce (Baker, Botts, Parker & Garwood on the brief) for Appellee.

Before Bryan and Foster, Circuit Judges, and Grubb, District Judge

OPINION—Filed June 18, 1930

BRYAN, Circuit Judge:

Appellee brought suit and recovered judgment against appellant, as collector of internal revenue, for the amount of federal income taxes paid under protest. Those taxes were assessed and collected upon net income derived from the sale of oil and gas produced from lands which appellee [fol. 75] held under lease from the State of Texas. The judgment was based on the theory that appellee was an instrumentality of the state, and as such was exempt as to the income involved from federal taxation. 38 F. (2) 680.

The leased lands from which the income was derived are parts of the public domain of Texas which long ago, by constitutional and statutory provisions, was set apart for the benefit of the State University. In 1917 an act of the legislature, chapter 83, provided for the leasing of university lands for the development of oil, gas and other natural resources. Lessees were required to pay royalties of one-eighth for oil and one-tenth for gas. By §27 of that act rights acquired under it were declared to be "subject to

taxation as is other property." That legislation was attacked as being in violation of a constitutional provision which permitted only the sale of university lands; but the Supreme Court of Texas held that the statutory leases constituted sales, and that the oil and gas when appropriated by the lessees formed no part of the university's permanent fund. Theisen v. Robison, 8 S. W. (2) 646. The royalty interest of the state is not involved, as the income tax act does not attempt to reach it.

Appellee, as is admitted, was liable for the income taxes assessed against it, unless it can claim exemption as a state instrumentality. It may be assumed without being decided that the state was entitled to claim exemption for itself, or even for appellee as its instrumentality, in developing the public domain. In a series of cases the Supreme Court of the United States has held that the State of Oklahoma could not interfere with lessees of Indian lands by imposing an occupation or privilege tax, Choctaw & Gulf R. R. Co. v. Harrison, 235 U. S. 292; by taxing such leases, Indian Oil Co. v. Oklahoma, 240 U. S. 522; by imposing a [fol. 76] tax on the gross value of the production of oil and gas less a royalty interest, Howard v. Oil Companies, 247 U. S. 503, and Large Oil Co. v. Howard, 248 U. S. 549; or by a tax upon the net income derived by a lessee from the sale of his share of oil and gas, Gillespie v. Oklahoma, 257 U. S. 501.

The last cited case, which reviews the previous ones, held that the lessee of an oil and gas lease of Indian lands was an instrumentality of the federal government in carrying out treaty obligations to the Indians. Appellee's position is that the converse of that proposition must be equally true, and that therefore it is an instrumentality of the state government of Texas in carrying out its public policy in developing lands which it holds for the benefit of its university. In our opinion the Gillespie case and the other cases from Oklahoma which preceded it are not in point. The state of Texas has no occasion to claim immunity for itself, and has not sought to exempt lessees of its university lands from federal income taxation. On the contrary, it has sold the mineral rights here involved and has provided that the rights of the purchaser or lessee "shall be subject to taxation as is other property." It cannot be doubted that the sovereign has the power to subject interests which

it has sold in public lands to taxation. Heiner v. Colonial Trust Co., 275 U. S. 232. In Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575, a case which also involves an oil and gas lease of Indian lands, it was held that the income of the lessee was subject to state taxation in Oklahoma under the Act of Congress of March 27, 1908, ch. 199, which in §4 provided "that all land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of [fol. 77] other persons than allottees of the Five Civilized Tribes." The language making the Indian lands subject to taxation is no broader or more comprehensive than is the language of the Texas statute making the rights of lessees of its university lands subject to taxation. The State of Texas by throwing the leases of university lands open to taxation generally, withdrew from the lessees all rights of exemption which might otherwise have existed. Our conclusion is that the taxes in question were properly assessed and collected, and consequently that it was error to give judgment for appellee.

The judgment is reversed, and the cause remanded for further proceedings not inconsistent with this opinion.

[fol. 78] IN UNITED STATES CIRCUIT COURT OF APPEALS,
FIFTH CIRCUIT

No. 5881

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS,

versus

GROUP NO. 1 OIL CORPORATION

JUDGMENT—June 18, 1930

This cause came on to be heard on the transcript of the record from the District Court of th United States for the Western District of Texas, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said Dis-

trict Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

[fols. 79-89] Petition for rehearing, covering 11 pages, filed July 7, 1930, omitted from this print. It was denied, and nothing more by order August 1, 1930.

[fol. 90] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

ORDER DENYING REHEARING—August 1, 1930

It is ordered by the Court that the petition for rehearing filed in this cause be, and the same is hereby, denied.

[fol. 91] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

MOTION FOR ORDER STAYING MANDATE—Filed Aug. 6, 1930

To the Honorable Judges of said Court:

Comes now Group No. 1 Oil Corporation, Appellee in the above entitled and numbered cause, and respectfully represents and shows to the Court that it is its purpose to apply to the Supreme Court of the United States for a writ of certiorari therein at as early a date as practicable and within the time limited by law. It, therefore, prays the Court to enter an order staying the issuance of the mandate in said cause for a reasonable time within which a petition for said writ of certiorari may be prepared and filed.

Respectfully submitted.

(Signed) Homer L. Bruce, Homer L. Bruce, Attorney for Appellee.

[fol. 92] Subscribed and sworn to before me, the undersigned authority, by Homer L. Bruce, this 4th day of August, 1930.

(Signed) C. H. Wilson, Notary Public in and for Harris County, Texas. (Seal.)

[fol. 93] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

ORDER STAYING MANDATE

On consideration of the application of the Appellee in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable Appellee to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is ordered that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that the certiorari petition, record and brief have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 6th day of August, 1930.

(Signed) Rufus E. Foster, United States Circuit Judge.

[fol. 94] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 95] SUPREME COURT OF THE UNITED STATES

ORDER GRANTING PETITION FOR REHEARING AND ALLOWING CERTIORARI—Filed November 24, 1930

On consideration of the petition for rehearing filed herein, and in view of the interest of the State of Texas, as

stated by it as amicus curiæ in support of the petition for rehearing, it is now here ordered by the Court that the said petition be, and the same is hereby, granted. The order heretofore entered on October 20, 1930, denying the petition for writ of certiorari herein is vacated, and it is ordered that the petition for writ of certiorari in this cause to the United States Circuit Court of Appeals for the Fifth Circuit be, and the same is hereby, granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 35,347. U. S. Circuit Court of Appeals, Fifth Circuit. Term No. 425. Group No. 1 Oil Corporation, petitioner, vs. James W. Bass, Collector of Internal Revenue for the United States for the First District of Texas. Petition for a writ of certiorari and exhibit thereto. Filed September 6, 1930. File No. 35,347.

FILED

SEP

CHARLES E.

No. 425

IN THE

Supreme Court of the United States

GROUP NO. 1 OIL CORPORATION, *Petitioner,*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

PETITION OF GROUP NO. 1 OIL CORPORATION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

GROUP NO. 1 OIL CORPORATION,
By HOMER L. BRUCE,
Attorney for Petitioner.

Of Counsel:
BAKER, BOTTS, PARKER & GARWOOD,
Houston, Texas.

McCURDY-YOUNG CO., HOUSTON

No.....

IN THE

Supreme Court of the United States

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*.

PETITION OF GROUP NO. 1 OIL CORPORATION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To the Honorable,
The Supreme Court of the United States:

Now comes Group No. 1 Oil Corporation and petitions for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to review the decision of said court in this cause, which decision reversed a judgment rendered by the United States District Court for the Western District of Texas, Austin Division, in favor of petitioner against respondent, and represents and shows to the court:

I.

Petitioner is a corporation organized under the laws of the State of Delaware with its principal office at El Paso, El Paso County, Texas, in the Western District

of that State. Respondent is the Collector of Internal Revenue for the United States for the First District of Texas, and resides at Austin, Travis County, Texas, in the Western District of Texas, and is there domiciled.

II.

SUMMARY AND SHORT STATEMENT OF THE MATTERS INVOLVED

(1) Brief Statement of the Question Involved.

This court in a series of cases arising from Oklahoma has held that the holders of oil and gas leases granted by the United States upon Indian lands are agencies and instrumentalities of the United States government, and the State of Oklahoma may not levy any taxes, including an income tax, upon such lessees. Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292; Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522; Howard v. Gipsy Oil Company, 247 U. S. 503; Large Oil Company v. Howard, 248 U. S. 549 (reversing the decision of the Supreme Court of Oklahoma in Large Oil Company v. Howard, 63 Okla. 143, 163 Pac. 537); Gillespie v. Oklahoma, 257 U. S. 501; and Jaybird Mining Company v. Weir, 271 U. S. 609. In the Gillespie case this court held invalid an income tax levied by Oklahoma upon the net income of such a Federal lessee. This court in The Collector v. Day, 78 U. S. (11 Wall.), 113, 127; United States v. Railroad Company, 84 U. S. (17 Wall.) 322, 327-8; Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584; and in Ambrosini v. United States, 187 U. S. 1, 7, and many other cases, has held that instrumentalities of the States are exempt from Federal taxation to the same extent and for the same reasons that similar Federal

instrumentalities are exempt from State taxation. Petitioner is the holder of oil and gas leases granted by the State of Texas on part of that State's public domain, and brought this suit to recover from the respondent Federal income taxes it had paid on income derived by petitioner solely from its operation of its State leases. The United States District Court for the Western District of Texas rendered judgment in petitioner's favor for $736,796.25, and held its income was exempt from the Federal income tax. The Circuit Court of Appeals for the Fifth Circuit reversed the judgment of the District Court, and held petitioner's income was not exempt. This is the first case before this court, so far as we are informed, in which an oil and gas lessee, holding a lease from a State, has asserted its exemption from Federal taxation on the same grounds upon which this court in the cases above cited held that a similar lessee, holding a lease from the United States, was exempt from State taxation.

(2) Statement of the Pleadings.

Petitioner filed its original petition (R. 2) to recover the income taxes it had paid under the Revenue Acts of 1924, 1926 and 1928, to respondent for the periods from July 1, 1924, to March 31, 1928, which taxes had been assessed against petitioner on account of income derived by it from its operation of oil and gas leases granted petitioner by the State of Texas on part of that State's public lands. Petitioner asserted its said income was exempt from these Federal income taxes on the following grounds:

The lands covered by the leases have always been a part of the public domain of the State of Texas, and

its predecessor governments, the Kingdom of Spain, the Republic of Mexico, the Republic of Texas, and finally the State of Texas. The United States, in the compact between the Republic of Texas and the United States under which the Republic of Texas became the State of Texas (as shown in 5 Stats. 797; 9 Stats. 108; Gammel's Laws of Texas, Vol. 2, pp. 1200, 1225 and 1228), expressly guaranteed that the State of Texas should retain its vacant and unappropriated lands, which included the specific tracts covered by petitioner's leases, and dispose of them as said State might direct. The lands involved herein had been set aside by the State for the support of the University of Texas, a University established and maintained by the State of Texas. In order for the State to secure the development of its oil and gas and other minerals and convert them into money for the benefit of the State and its University, the State of Texas granted oil and gas leases upon University lands, reserving a royalty equal to one-eighth of the oil and one-tenth of the gas. Petitioner held two such leases (copies of which are set forth at R. 18 and 28). The income taxes paid to respondent were assessed on income derived by petitioner solely from the sale of oil and gas produced by it from these State leases and from its operation of the leases. Petitioner had other taxable income, but this was more than offset by properly deductible expenses, and none of the taxes paid were assessed because of this outside taxable income. Its claims to exemption from the Federal income taxes may be summarized as follows:

1. The taxes are a burden on the power and right of the State of Texas to develop its own oil and gas

resources, and could be used by the Federal Government to destroy that power and right.

2. The taxes are a burden upon the leases and the petitioner as the owner thereof, chosen by the State as means to develop its mineral resources, and could be used to render them impotent as such means and agencies.

3. The taxes are upon the rights and franchises granted by the State.

4. The leases are exempt from Federal taxation, and petitioner's income therefrom is likewise exempt.

5. The taxes prevent the petitioner from producing the maximum amount of oil and thus reduce the State's returns through its royalties.

6. If these taxes could be levied by the Federal Government on the State's lessees, this would have a sensible influence on the terms the State could require in the leases and the amount of royalties it could reserve.

It alleged the taxes were invalid on each of the foregoing grounds, both under the Constitution of the United States and under the express guarantee of the United States in its compact with the Republic of Texas that the new State of Texas should retain its public lands as its own and dispose of them as it deemed best.

All necessary prerequisites under the revenue laws as to filing claims for refund and their rejection before the suit was filed were alleged, and were admitted by respondent.

The respondent filed a formal answer (R. 29), and an agreed Statement of Facts (R. 31) was filed, which admitted all the allegations of petitioner except those

alleging the legal propositions on which petitioner based its claim to exemption. The effect was to narrow the issues to the one question of whether the petitioner was under the facts alleged exempt from the Federal income taxes.

(3) Trial of the Cause and Result Thereof.

The case was tried on October 19, 1929, before the court on written waiver of a jury. (R. 30.) On February 19, 1930, the court filed its opinion (R. 39), sustaining petitioner's contentions in full, and on February 28, 1930, entered judgment in petitioner's favor for the taxes sued for. (R. 54.)

(4) Proceedings in Circuit Court of Appeals.

Respondent in due course was allowed an appeal from the judgment aforesaid. The cause was heard by the United States Circuit Court of Appeals for the Fifth Circuit, at New Orleans, Louisiana, being Cause No. 5881 on the docket in that court, and on June 18, 1930, said court rendered its opinion (R. 73) and entered its order and judgment (R. 75) reversing the judgment of the District Court on the ground that by Section 27 of the 1917 Leasing Act, which section is as follows:

> "Rights acquired under this Act shall be subject to taxation as is other property,"

under which Act petitioner's leases were granted, the State of Texas granted the United States permission to levy these income taxes on the petitioner, the State's instrumentality. The court so construed this Section 27 notwithstanding that said section was intended to refer solely to taxation by the State and its subdivisions, that it did not refer either expressly or impliedly to

Federal taxation, and notwithstanding that this court in Van Brocklin v. Tennessee, 117 U. S. 151, 175; Owensboro National Bank v. Owensboro, 173 U. S. 664, 668; First National Bank v. Adams, 258 U. S. 362, 364; Jaybird Mining Company v. Weir, 271 U. S. 609, 613; and Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575, 578, 579, has specifically held that neither the United States nor any State may tax the property or the agencies or instrumentalities of the other without its express consent, and if in any instance such consent is granted, only those taxes that fall clearly within the class of taxes embraced therein will be sustained.

Thereafter, in due time, on July 7, 1930, petitioner filed in said United States Circuit Court of Appeals its motion for a rehearing (R. 77), which motion was considered by said court and on August 1, 1930, denied (R. 89); and thereupon the judgment of reversal in said cause became and was a final judgment.

III.

A certified copy of the entire record of said cause, including the proceedings in said Circuit Court of Appeals, is herewith furnished as an exhibit to this petition in compliance with Rule 38 of this honorable court.

IV.

Reasons Relied Upon for Allowance of Writ of Certiorari.

Petitioner is advised and believes, and, accordingly, submits that said judgment of the United States Circuit Court of Appeals in said cause is erroneous, and that this honorable court should require said cause to be

certified to it for its review and determination in conformity with the provisions of Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stats. 938.

Petitioner represents, as it submits will become apparent from what follows, that this cause involves questions of law of gravity and importance, involving the construction of the Constitution and laws of the United States and of the said treaty between the United States and the Republic of Texas; that the Circuit Court of Appeals has decided important questions of constitutional and general law in a way probably untenable and in conflict with the weight of authority; that it has decided the Federal questions herein presented in a way probably in conflict with applicable decisions of this court; and that it has so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this court's power of supervision; in that said Circuit Court of Appeals for the Fifth Circuit, by reversing the judgment and decree of the District Court, committed errors which petitioner now here assigns in this court as follows:

1. The court erred in reversing the judgment and decree in petitioner's favor because all questions of law in this case have been decided in favor of petitioner by this court in Gillespie v. Oklahoma, 257 U. S. 501, and the other cases above referred to arising from Oklahoma, and on the authority of those cases the judgment of the District Court should have been affirmed.

2. The court erred in reversing the judgment and decree in the petitioner's favor because said income taxes are a tax upon and burden, impede, impair, control, and

are in derogation of, the power and the right of the State of Texas to develop and realize on its oil and gas resources in and under its lands for its own benefit, and if the United States Government has the power to levy and collect such taxes, this power could be used by the United States Government to destroy and render valueless said power and right of the State of Texas, in violation of and contrary to the Constitution of the United States and said treaty between the United States and the Republic of Texas.

3. The court erred in reversing the judgment and decree in petitioner's favor because said income taxes are a tax upon and burden, impede, impair, and control petitioner and its said leases, and because petitioner and its leases have been chosen by said State as its agencies and instrumentalities for exercising its power and right to develop and realize upon its oil and gas resources for the benefit of itself, and if the United States Government had the power to levy and collect such taxes, this power could be used by the United States to destroy and render impotent said means and instrumentalities of the State of Texas, in violation of and contrary to the Constitution of the United States and said treaty between the United States and the Republic of Texas.

4. The court erred in reversing the judgment and decree in petitioner's favor because said income taxes are a tax upon and burden, impede, impair, control, and are in derogation of, the rights, privileges, licenses and franchises obtained by petitioner under said leases from the State of Texas, and if the United States Government had the power to levy and collect such taxes, this power could be used by the United States Govern-

ment to destroy and render valueless said rights, privileges, licenses and franchises obtained by petitioner from the State of Texas, in violation of and contrary to the Constitution of the United States and said Treaty between the United States and the Republic of Texas.

5. The court erred in reversing the judgment and decree in petitioner's favor because said rights, privileges, licenses and franchises obtained by petitioner under said leases from the State of Texas and said leases are exempt from taxation by the United States under the Constitution of the United States and said Treaty between the United States Government and the Republic of Texas, and the income derived by the petitioner therefrom is likewise exempt from such taxation.

6. The court erred in reversing the judgment and decree in petitioner's favor because said income taxes burden, impede, impair, control and arrest this taxpayer, as said instrumentality, in its development of the lands of said State for oil and gas and in producing oil and gas therefrom, and prevents the State of Texas from obtaining the greatest return from its royalties on the oil and gas produced from said lands, and if the United States Government had the power to levy and collect such taxes, said power could be used by the United States Government to prevent this taxpayer from developing said lands for oil and gas and from producing oil and gas therefrom, with the result that the State of Texas would be prevented from realizing anything upon the royalties to be paid it under said leases, in violation of and contrary to the Constitution of the

United States and said Treaty between the United States and the Republic of Texas.

7. The court erred in reversing the judgment and decree in petitioner's favor because, if the United States had the power to levy and assess income taxes upon the holders of oil and gas leases granted by the State of Texas upon its public domain, this power would have a sensible influence on the terms of said leases that the State of Texas could demand and require, and the consideration that the State of Texas could require and obtain therefor, and the amount of royalties said State could reserve, and said power could be used to such an extent by the United States Government that the State of Texas would be required to grant said leases on terms more disadvantageous to it and for less consideration and for less royalties reserved, and could be used by the United States to render it impossible for the State of Texas to realize a reasonable amount, if anything at all, from its leases and from its said oil and gas resources, in violation of and contrary to the Constitution of the United States and said Treaty between the United States and the Republic of Texas.

8. The court erred in reversing the judgment and decree in petitioner's favor on the ground that by Section 27 of the 1917 Leasing Act the State of Texas granted to the United States permission to levy these income taxes on the State's lessees because said Section 27 dealt solely with taxation of the leases by the State of Texas and its subdivisions and did not in any manner refer to taxes to be levied by the United States, and the State of Texas will not be held to have consented to taxation of its instrumentalities by the United States unless it has expressly given its consent, and

this question was decided by this court in favor of petitioner in the cases hereinbefore referred to, and on the authority of those cases the said court should not have construed said Section 27 as allowing these taxes to be levied by the United States.

9. The court erred in reversing the judgment and decree in petitioner's favor on the ground that by said said Section 27 the State of Texas permitted the United States to levy these taxes because said Section 27 was repealed by the Texas Legislature on March 10, 1925, by Chapter 71, page 225, 39th Legislature, before any of the taxes involved in this cause were levied or became due.

10. The court erred in reversing the judgment and decree in petitioner's favor in relying to any extent on the decision of the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489, 8 S. W. (2nd) 646, that these leases constituted sales of the minerals, because the sole question before the Supreme Court of Texas in said case was whether these leases violated the provisions of Section 12, Article 7, of the State Constitution that lands set apart for the University of Texas should be sold; and it held merely that, since under the laws of Texas title to the oil and gas in place passed to the lessee on the execution of a lease, subject to reversion to the landowner on forfeiture of the lease, oil and gas leases in Texas in thus transferring title to the oil and gas in place were sales within the meaning of the Texas Constitution; and the levy of these income taxes is as much in derogation of the State's power and right to develop its oil and gas through lessees as its instrumentalities, free from interference from the United States, as they would be if under the

laws of Texas title to the minerals in place remained in the lessor; and to sustain these income taxes on the ground that these leases constituted sales is to do so by the use of a delusive name.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this court directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this court on a day certain, to be therein designated, a full and complete Transcript of the Record and all of the proceedings in said Circuit Court of Appeals in said cause, entitled "James W. Bass, Collector of Internal Revenue for the United States for the First District of Texas, Appellant, v. Group No. 1 Oil Corporation, Appellee," No. 5881 on its docket, to the end that said cause may be reviewed and determined by this court as provided by Section 240 of the Judicial Code, as amended, and that your petitioner may have such other or further relief or remedy in the premises as this court may deem appropriate and in conformity with said provision of the Judicial Code, and that said judgment of the Circuit Court of Appeals be reversed by this honorable court and the judgment of the District Court be affirmed, and such relief granted as is appropriate to the cause.

GROUP NO. 1 OIL CORPORATION,
By HOMER L. BRUCE,
Attorney for Petitioner.

Of Counsel:
BAKER, BOTTS, PARKER & GARWOOD,
Houston, Texas.

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No. 425

IN THE

Supreme Court of the United States

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

BRIEF OF GROUP NO. 1 OIL CORPORATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

— BY —

HOMER L. BRUCE,
Solicitor for Petitioner.

Of Counsel:
BAKER, BOTTS, PARKER & GARWOOD,
Houston, Texas.

McCURDY-YOUNG CO., HOUSTON

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No.....

IN THE

Supreme Court of the United States

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

BRIEF OF GROUP NO. 1 OIL CORPORATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

Opinions of the Courts Below.

The opinion of the District Court in this cause is reported:

Group No. One Oil Corporation v. Bass, Collector of Internal Revenue, 38 Fed. (2d) 680. (R. 39.)

The opinion of the Circuit Court of Appeals for the Fifth Circuit in the cause has not yet been officially deported. (R. 73.)

II.

Jurisdiction.

Jurisdiction of this court is invoked under Section 240 of the Judicial Code, as amended by the Act of Feb-

ruary 13, 1925, 43 Stats. 938. The judgment sought to be reviewed is that of the Circuit Court of Appeals for the Fifth Circuit rendered June 18, 1930 (R. 75), which became a final judgment by the overruling of petitioner's motion for a rehearing (R. 77) on August 1, 1930. (R. 89.) The judgment of the Circuit Court of Appeals reversed the judgment rendered on February 28, 1930, by the District Court for the Western District of Texas, Austin Division (R. 54), in favor of petitioner, against the respondent, for $736,796.25 of income taxes paid to respondent by petitioner.

The petitioner brought this suit to recover income taxes paid by it to respondent on income derived by petitioner from the sale of oil and gas produced by it under leases from the State of Texas upon part of that State's public domain, and from its operations on said leases. Petitioner's claim was that, under both the Constitution of the United States and the treaty between the United States and the Republic of Texas under which the latter became the State of Texas, such income was exempt from Federal income taxes because petitioner and its leases were the agencies and instrumentalities selected by the State of Texas as appropriate means whereby the State could secure the development of its oil and gas under its public domain to the best advantage of the State and convert its interest in these minerals into money, and such taxes hinder, and are in derogation of, the State's power and right to develop its own mineral resources free from any interference on the part of the United States. (Original Petition, R. 2.)

This court, in Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292; Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522;

Howard v. Gipsy Oil Company, 247 U. S. 503; Large Oil Company v. Howard, 248 U. S. 549 (reversing the decision of the Supreme Court of Oklahoma in Large Oil Company v. Howard, 63 Okla. 143, 163 Pac. 537); Gillespie v. Oklahoma, 257 U. S. 501; and Jaybird Mining Company v. Weir, 271 U. S. 609, all cases arising from Oklahoma, has held that the holders of oil and gas leases granted by the United States upon Indian lands are agencies and instrumentalities of the United States, and as such are exempt from taxation by Oklahoma. This court has likewise held in The Collector v. Day, 78 U. S. (11 Wall.) 113, 127; United States v. Railroad Company, 84 U. S. (17 Wall.) 322, 327, 328; Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584; and in Ambrosini v. United States, 187 U. S. 1, 7, and many other cases, that instrumentalities of the States are exempt from Federal taxation to the same extent and for the same reasons that Federal instrumentalities are exempt from State taxation.

The District Court, in its opinion (R. 39), sustained petitioner's claim, and on February 28, 1930, rendered judgment against respondent for all the taxes sued for. (R. 54.) The Circuit Court of Appeals, on June 18, 1930, reversed the judgment of the District Court, and held petitioner's income was taxable. (R. 73, 75.)

Jurisdiction of this court is invoked under Section 240 of the Judicial Code, as amended, on the following grounds:

(*a*) That the cause involves grave questions of vital importance to the public, involving the construction of the Constitution and laws of the United States and of the said treaty between the United States and the Republic of Texas.

(*b*) That the Circuit Court of Appeals has decided important questions of constitutional and general law in a way probably untenable and in conflict with the weight of authority.

(*c*) That the Circuit Court of Appeals has decided the Federal questions herein presented in a way probably in conflict with applicable decisions of this court.

(*d*) That this is the first case before this court in which the holder of an oil and gas lease from a State is claiming the exemption from Federal taxation that this court held in the Oklahoma cases applied to lessees from the United States as far as State taxation was concerned.

(*e*) That the Circuit Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this court's power of supervision.

III.

Statement of the Case.

A statement of the case has been given under heading II in the petition for a writ of certiorari, and in the interest of brevity is not repeated at this point.

IV.

Specification of Errors.

The assigned errors intended to be urged are fully set forth in the petition for writ of certiorari, and may be summarized as follows:

1. The Circuit Court of Appeals erred in reversing the judgment of the District Court because on the authority of the decision in Gillespie v. Oklahoma, 257 U.

S. 501, and the other decisions of this court referred to, petitioner is exempt from the Federal income tax as an instrumentality of the State of Texas.

2. The said court erred in reversing the judgment of the District Court because the taxes involved are a burden upon, impair, and are in derogation of, said State's right, under the Constitution of the United States and the treaty between the United States and the Republic of Texas, to develop its own mineral resources free from interference by the United States, and are an unauthorized burden upon petitioner and its leases, the agencies chosen by the State for the purpose of exercising this right.

3. The said court erred in holding that by Section 27 of the 1917 leasing act the State of Texas granted its permission to the United States to levy these taxes upon its instrumentality, the petitioner, because said section dealt solely with taxation by said State and its subdivisions, and not with taxes levied by the United States.

4. The said court erred in holding the collection of said taxes was allowed under said Section 27 because said section was repealed on March 10, 1925, before any of said taxes were levied or became due.

5. The court erred in holding, if in fact it did hold, that under the decision of the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489, petitioner was not an instrumentality of the State, but was merely a purchaser of the minerals, because neither petitioner's leases nor said decision of the Supreme Court of Texas sustain such a holding.

Petitioner now seeks a writ of certiorari to said Circuit Court of Appeals to the end that said cause may be

reviewed by this court, the petition for which is filed herewith. In support thereof it respectfully submits the following brief reference to the principles of law, to some of the decisions and to the statutes which govern the questions.

Preface to Argument.

The District Court, in its opinion, held on the principal authority of Gillespie v. Oklahoma, 257 U. S. 501, and the other Oklahoma cases, that petitioner, as an agency of the State, was exempt from the Federal income tax. The Circuit Court of Appeals based its reversal of the District Court's judgment on the one ground that the State, by Section 27 of the 1917 leasing act, reading "Rights acquired under this Act shall be subject to taxation as is other property," withdrew from its lessees all rights of exemption from Federal taxation to which they were otherwise entitled. When the fundamental nature of the principles involved in this cause are fully appreciated, we submit it will be apparent that the State of Texas has not by this simple provision waived all the benefits that would otherwise accrue to it. For that reason we beg leave to refer to these principles before dealing specifically with this Section 27. Our discussion of it and the construction placed on it by the Circuit Court of Appeals will be found under Points D and E of this brief.

ARGUMENT

Point A.

The leases under which petitioner produced the oil and gas from the public domain of the State of Texas

covered thereby, and petitioner as the owner thereof, are the means, agencies and instrumentalities chosen by the State of Texas for developing the State's oil and gas, and the United States had no power or authority to levy the income taxes on the income of petitioner from its leases.

The facts and legal principles involved are well set forth in the opinion of the District Court. (R. 39.) We will briefly review them.

Copies of the leases, which are substantially identical in form, are set forth in the record. (R. 18, 23.) The lands involved have always been part of the public domain of the State of Texas and its predecessor governments, the Kingdom of Spain, the Republic of Mexico, and the Republic of Texas. The Republic of Texas became the State of Texas after lengthy negotiations between the two independent nations, the United States and the Republic of Texas, and did so under certain specific guarantees set forth in the resulting compact between the two republics. The resolutions of the two governments may be found in 5 Stats. 797, 9 Stats. 108, and Gammel's Laws of Texas, Vol. 2, pp. 1200, 1225 and 1228, and copies are annexed to this brief at page i of the Appendix. Part of this compact is as follows:

> "2. And be it further resolved, that the foregoing consent of Congress is given upon the following conditions, and with the following guarntees, to wit:
>
> "Second. **Said State * * * shall also retain all the vacant and unappropriated lands lying within its limits,** to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after discharging said debts and liabilities, **to be disposed of as said State**

may direct; but in no event are said debts and liabilities to become a charge upon the Government of the United States."

While still an independent nation, the Republic of Texas on January 26, 1839 (Laws of 1839, p. 134), directed the President to set aside 50 leagues of land for two universities, and by the Act of February 11, 1858 (Laws of 1858, p. 148), established "an Institution of Learning, to be styled 'The University of Texas'," and set aside additional land for it. The State Constitution of 1876, Article VII, Sections 10 to 15 (Appendix p. *ix*), provided for "The University of Texas" to be established as a University of the first class, and Section 15 set aside 1,000,000 acres for its endowment and support. By the Act of March 30, 1881 (Laws of 1881, p. 79), the present University was finally created. It is strictly a State maintained and controlled school. Articles 2584 to 2606 and 2907, Revised Statutes of Texas of 1925, deal with its management, but their details are immaterial. Petitioner's leases are on part of these University lands.

The State, not desiring to engage in the highly speculative oil business, has elected to have its oil and gas produced in the usually accepted manner of granting leases and reserving a royalty of part of the oil and gas produced. The State has continuously been modifying its leasing laws to obtain the best results, the principal ones being the Act of April 9, 1913, Chap. 173, p. 409, 33rd Legislature; March 16, 1917, Chap. 83, p. 158, 35th Legislature (Appendix p. *xii*); March 10, 1925, Chap. 71, p. 225, 39th Legislature (Appendix p. *xxvi*); January 11, 1929, Chap. 2, p. 6, 41st Legislature (Appendix p. *xxxvi*); March 29, 1929, Chap. 282, p. 616, 41st Legis-

lature (Appendix p. *xxxix*). These acts have been amended many times in immaterial particulars.

Petitioner's leases were granted under the 1917 Act, which provided substantially as follows:

Permits to explore for oil and gas were first issued, and on the discovery of oil or gas, leases were granted by the Commissioner of the General Land Office for ten years with an option to renew as long as oil or gas were produced. In addition to the initial cash payment of two dollars per acre, the lessee was required to pay a royalty equal to one-eighth of the value of the gross production of oil and one-tenth of gas. The Commissioner was authorized to provide such further terms and regulations as he deemed best for the protection of the State. The leases contained the following provisions: (1) the lessee was required to use reasonable diligence to develop the properties and produce the oil and gas; (2) offset wells must be drilled to prevent drainage by wells on adjoining property; (3) if the lessee failed to perform the conditions of the lease, or pay the royalties, or comply with any regulations of the Commissioner, the leases were subject to forfeiture.

The sole purpose of the State in granting these leases was to realize upon its interest in the minerals through its royalties. This is clear from the Leasing Acts themselves, and the frequent legislation on the subject. Petitioner alleged such to be its purpose (R. 9, par. VIII), and it was admitted in the agreed Statement of Facts. (R. 35, par. VIII.)

This court has held that similar leases and lessees from the Federal government covering Indian lands in Oklahoma are instrumentalities of the United States and exempt from taxation by the State of Oklahoma, be-

cause such taxes are a hindrance upon the right and power of the United States to develop the minerals for the best interest of the Indians. These cases are Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292 (a tax on the gross production of a mine); Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522 (a tax upon the leases); Howard v. Gipsy Oil Company, 247 U. S. 503; Large Oil Company v. Howard, 248 U. S. 549, reversing the Supreme Court of Oklahoma decision in 63 Okla. 143 (a tax on the gross production after deduction of the royalty); Gillespie v. Oklahoma, 257 U. S. 501 (an income tax upon the net income of the lessee); Jaybird Mining Companay v. Weir, 271 U. S. 609 (an ad valorem tax on the minerals mined).

The applicable rules are succinctly stated by Justice Holmes in the Gillespie case as follows:

> "The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist and make laws. New York, New Haven & Hartford R. R. Co. v. New York, 165 U. S. 628. Diamond Glue Co. v. United States Glue Co., 187 U. S. 611, 616. The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance. Williams v. Talladega, 226 U. S. 404, 416, 417, 419. Johnson v. Maryland, 254 U. S. 51, 55. 'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon income from the leases is not long.
>
> "In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and

if a part of it comes from such a source the tax is *pro tanto* void; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429; 158 U. S. 601; rule lately illustrated by Evans v. Gore, 253 U. S. 245; and applied in a case somewhat like the present by the Supreme Court of Hawaii, Oahu R'y & Land Co. v. Pratt, 14 Hawaii 126. Whether this property could be taxed in any other form or not, it cannot be reached as profits or income from leases such as those before us."

Further quotations from these opinions will not be made. They decisively settle the fundamental principles involved in this cause. They establish the two propositions: first, that an oil and gas lessee holding under one government falls within that class of instrumentalities that may not be taxed by the other government; and, second, that an income tax on the lessee's income is one of the forbidden taxes.

Petitioner, as a lessee from the State of Texas, is to the same extent and for like reasons exempt from the Federal income tax. In The Collector v. Day, 78 U. S. (11 Wall.) 113, 127, this court said:

"And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the State depending upon their reserved powers, for like reasons, exempt equally from Federal taxation? Their unimpaired existence in the one case is as essential as in the other. * * * In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; and any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government. Of what avail are these

means if another power may tax them at discretion?"

In Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584, it is stated:

> "As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State."

See also United States v. Railroad Company, 84 U. S. (17 Wall.) 322, 327; Ambrosini v. United States, 187 U. S. 1, 7.

The decision in the Gillespie case as to the Federal lessee applies with equal force to the petitioner in this cause. Under that case this State lessee is an instrumentality of the State, and as such the United States may not tax its income from its leases.

These Oklahoma cases, and particularly Gillespie v. Oklahoma, are now among the leading authorities on the question of exemption of governmental instrumentalities. Long v. Rockwood, 277 U. S. 142, 148; Panhandle Oil Company v. Knox, 277 U. S. 218, 222; The Macallen Company v. Massachusetts, 279 U. S. 620, 627; Northwestern Mutual Life Insurance Company v. Wisconsin, 275 U. S. 136, 140, in which it was said:

> "Certainly since Gillespie v. Oklahoma, 257 U. S. 501, 505, it has been the settled doctrine here that where the principal is absolutely immune, no valid tax can be laid upon income arising therefrom."

When the underlying reasons and the long line of decisions of this court, beginning with M'Culloch v. Mary-

land, 4 Wheat. 316, are considered, it inevitably follows that one government may not tax the other government's oil and gas lessees. We will not review in detail the numerous decisions of this court, but desire to call attention merely to a few typical extracts from its opinions:

> "There is no express provision for the case, but the claim has been sustained on a principle which so entirely pervades the Constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it without rending it into shreds. * * *
>
> "These are, 1st, that a power to create implies a power to preserve. 2nd, that a power to destroy, if wielded by a different hand, is hostile to, and incompatible with, those powers to create and to preserve. 3rd, that where the repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme. * * *
>
> "The court has bestowed on this subject its most deliberate consideration. The result is a conviction that the States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government." M'Culloch v. Maryland, 4 Wheaton 316.

> "Congress has power 'to borrow money on the credit of the United States.' The stock it issues is the evidence of a debt created by the exercise of this power. The tax in question is a tax upon the contract subsisting between the government and the individual. It bears directly on that contract, while subsisting and in full force. The power operates upon the contract the instant it is framed, and must imply a right to affect that contract. * * *
>
> "The right to tax the contract to any extent, when made, must operate upon the power to bor-

row before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of the government. It may be carried to an extent which shall arrest them entirely." Weston v. City Council of Charleston, 27 U. S. (2 Peters) 449, 465, 466, 468; Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 586; The Macallen Company v. Massachusetts, 279 U. S. 620, 624.

"Is not compensation the means by which his services are produced and retained? It is true it becomes his when he has earned it. If it can be taxed by a State as compensation, will not Congress have to graduate its amount, with reference to its reduction by the tax? Could Congress use an uncontrolled discretion in fixing the amount of compensation, as it would do without the interference of such a tax?" Dobbins v. Commissioners of Erie County, 41 U. S. (16 Peters) 435, 448.

"And it must be always remembered, if the right to impose a tax at all exists on the part of the other government, 'it is a right which in its nature acknowledges no limits.' And the principle is equally true in respect to every other power or function of a government subject to the control of another." Bank of Commerce v. New York City, 67 U. S. (2 Black) 620, 634.

"This carries with it an exemption of those agencies and instruments from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. Their operation may be impeded and may be destroyed, if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other." United States v. Railroad Company, 84 U. S. (17 Wall.) 322, 327, 328.

"Applying this language to these municipal securities, it is obvious that the taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution." Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 586.

"And to tax the bonds as property in the hands of the holders is, in the last analysis, to impose a tax upon the right of the municipality to issue them." Farmers & Mechanics Savings Bank v. Minnesota, 232 U. S. 516, 526.

"With regard to taxation, no matter how reasonable, or how universal and undiscriminating, the State's inability to interfere has been regarded as established since M'Culloch v. Maryland, 4 Wheat. 316. The decision in that case was not put upon any consideration of degree but upon the entire absence of power on the part of the States to touch, in that way at least, the instrumentalities of the United States; 4 Wheat. 429, 430; and that is the law today. Farmers & Mechanics Savings Bank v. Minnesota, 232 U. S. 516, 525, 526." Johnson v. Maryland, 254 U. S. 51, 55.

"The principle set forth a century ago in Weston v. Charleston, 2 Pet. 449, 468 (7 L. Ed. 481), has never since been departed from by this court:

"'The right to tax the contract to any extent, when made, must operate upon the power to borrow, before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government; to any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely.' Home Savings Bank v. Des Moines, 205

U. S. 503, 513; 27 S. Ct. 571, 51 L. Ed. 901. • • •

"Not only may the power to tax be exercised oppressively, but for one government—State or national—to lay a tax upon the instrumentalities or securities of the other is derogatory to the latter's dignity, subversive of its powers, and repugnant to its paramount authority. See California v. Central P. R. Co., 127 U. S. 1, 41; 8 S. Ct. 1073 (32 L. Ed. 150)." The Macallen Company v. Massachusetts, 279 U. S. 620.

The foregoing quotations apply themselves to the present cause without the need of assisting comment on our part. The taxes are stricken down because they are an impediment upon the power of the State of Texas to obtain the greatest return from the minerals under its public domain, in which activity it is beyond any control by the United States. The levy of these taxes would imply the right by the United States to affect the terms of the leases and would have a sensible influence on the royalties reserved by the State. The net income of the lessee is the compensation received by it from the State for its services in producing the State's royalty portion of the oil. If the United States may reduce this compensation through the income tax, the State would have to increase it by reducing its reserved royalties, and could not use its uncontrolled discretion in fixing their amount. There is no question of degree of taxation, whether it is burdensome or not, or whether it is universal and undiscriminating. This burden on the State's agency is a continuous one. The State's returns through its royalties depend upon the amount of oil produced. Taxes paid to the Federal government reduce the funds available to the lessee for further drilling, exploration and producing operations. It is

well known that reductions in the price of oil curtail drilling and the bringing in of new wells, and in the same manner increases in the income tax rate reduce the operations of lessees. The levy of these taxes amounts to the United State's demanding what is known as a working interest in the State of Texas' oil properties. It is even more stringent than an ordinary working interest of a third party, which is fixed and certain. The working interest of the United States for any year may not be known during the entire year. The tax rate may not be fixed until the next year, as was the case of the Revenue Act of 1926, which was retroactive to January 1, 1925. The United States has no power or right to demand that it be carried for this indefinite and fluctuating working interest in the oil lands of the State of Texas, which working interest, if permitted, is fixed by the United States in its uncontrolled discretion and without consultation with the State of Texas.

It is clear therefore that these taxes are an unauthorized burden upon the State of Texas.

Point B.

The State of Texas may not be hindered or impeded in any manner by the United States in developing its own oil and gas resources on its public domain.

The lands involved in this cause have always been the public domain of the State and its predecessor governments. It became a State under the express guarantee that it should "retain all the vacant and unappropriated lands lying within its limits," and, after using them to pay its debts, the lands remaining were "to be disposed of as said State may direct."

Not only under the Constitution of the United States but also under the above express guarantee, the State of Texas has the sovereign right to retain, own, cultivate, and utilize these lands and enjoy all the rights and privileges of ownership in them and ultimately to dispose of them. The States may levy no taxes upon property of the United States (Van Brocklin v. Tennessee, 117 U. S. 151; Wisconsin Central Railroad Co. v. Price County, 133 U. S. 496; Lee v. Osceola & Little River Road Improvement District No. 1, 268 U. S. 643; Irvin v. Wright, 258 U. S. 219, 228), and for the same reasons the United States may not tax the lands of the State of Texas. As the United States may not tax the State's interest as a whole in these lands, it may tax no part thereof or impede the State in enjoying any of the separate rights making up its entire ownership. One of these individual rights is that of developing its minerals through the usual method of leases. The income taxes infringe this right.

This is not a case of the State's going into a private line of business and drying up sources of Federal taxation, as was held in South Carolina v. United States, 199 U. S. 437. In that case the court held that South Carolina's saloon keepers were not exempt from the Federal excise tax because to hold otherwise would allow a State, mingling the thought of profit with the necessity of regulation, to take over all lines of business and thus remove all sources of Federal revenue. The State of Texas has not bought these lands with the view of going into the oil business. It is merely seeking to realize on the minerals that it and its predecessors have always owned as public property. No pre-existing source of Federal revenue is being affected,

as in the South Carolina case. The United States may levy no taxes on these lands nor impede the State of Texas in whatever use it makes of them. No one may drill them until the State grants a lease, and therefore there can be no income, whether subject to Federal taxes or not, until the State acts.

The respondent may contend the lands now belong to the University of Texas and not the State. The University is a mere branch of the State government, and property set aside for its benefit is still the State's property, and the State does not hold it even as a trustee. York v. Alley, 25 S. W. (2nd) 193, (Texas Court of Civil Appeals); Smisson v. State, 71 Tex. 222, 231, 9 S. W. 112.

It is immaterial for what purpose the State uses the revenue from its oil lands. It has the right to produce its oil free from Federal control or hindrance, and its use of such revenue occurs after the point where these taxes would attach has been passed.

However, its use of the revenue for the University of Texas for the education of its youth is a public one. Cochran v. Louisiana State Board of Education, 281 U. S. 370; Phillips v. Virginia University, 97 Va. 472, 34 S. E. 66; Hjorth Royalty Co. v. Trustees of University of Wyoming, 30 Wyo. 309, 222 Pac. 9. Public schools and universities have been maintained and operated from the earliest colonial times. They were conducted by the colonies. Nelson's Encyclopedia, Vol. 10, p. 91; The Americana, Vol. 27, History of University of Columbia, Vol. 29, p. 337; Ellwood P. Cubberly, "An Introduction to the Study of Education," pages 1-4, 62-3, 357-8. They were authorized by the early State constitutions and colonial laws. (The page

references are to The Federal and State Constitutions, Colonial Charters and other Organic Laws of the United States, compiled under an order of the United States Senate by Ben. Perley Moore, 1878.) Constitutions of Georgia, 1777, Art. LIV, p. 383; Massachusetts, 1780, Art. III, p. 957, Chap. V, p. 970; New Hampshire, 1784, p. 1291; North Carolina, 1776, Art. XLI, p. 1414; Vermont, 1777, Sec. XL, p. 1865; 1786, Sec. XXXVIII, p. 1874; 1793, Sec. 41, p. 1882; Pennsylvania Frames of Government, 1683, Sec. XII, p. 1521; 1696, p. 1535; Constitutions of 1776, Sec. 44, p. 1547; 1790, Art. VII, p. 1553; The Northwest Territorial Government Act of July 13, 1787, Art. III, p. 431. In 1806 (2 Stats. 381) the Federal government required Tennessee to set aside large tracts for two colleges and for academies in each county. In enabling Acts admitting States into the Union the Federal government has consistently set aside lands for the exclusive use of public schools, seminaries and universities. Ohio, 1802, 2 Stats. 173; Indiana, 1816, 3 Stats. 289; Illinois, 1818, 3 Stats. 428; Alabama, 1819, 3 Stats. 489; Missouri, 1820, 3 Stats. 545; Arkansas, 1836, 5 Stats. 58; Iowa, 1845, 5 Stats. 789; Wisconsin, 1846, 9 Stats. 56; Minnesota, 1857, 11 Stats. 166; Oregon, 1859, 11 Stats. 383; Nevada, 1864, 13 Stats. 30; Nebraska, 1864, 13 Stats. 47; Colorado, 1875, 18 Stats. 474; and many others. Public education is the rule, and private schools are the exception. 24 Ruling Case Law 558. Respondent's contentions to the contrary were overruled by both the District Court and the Circuit Court of Appeals.

Point C.

The leases held by petitioner from the State of Texas,

and the petitioner as the owner thereof are agencies and instrumentalities of the State of Texas.

There is no essential difference between petitioner's leases and those involved in Gillespie v. Oklahoma and the other cases arising from Oklahoma. The end sought by the United States and Texas in each instance is the same. Just as this court said in Jaybird Mining Company v. Weir, 271 U. S. 609:

> "In this case, the lease was made to secure the development of the lands and obtain for the benefit of the restricted Indian owners a percentage of the gross proceeds of the ores to be mined,"

so in this case the leases were made to secure the development of the lands and obtain for the benefit of the State of Texas a percentage of the gross proceeds of the oil and gas produced.

Inasmuch as respondent has relied in the lower courts, and may rely in this court, on the decision of the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489, 8 S. W. (2nd) 646, we will review it. The opinions of both the lower courts show they considered the Theisen case, but did not agree with respondent's contentions with respect to it. A brief review of that case and its surrounding circumstances will demonstrate that it has no material bearing upon this case. Respondent's contention has been that under the Theisen case the State did not lease the lands to petitioner, but petitioner bought the oil and gas it produced and its income was derived merely from its resale, and, therefore, it is the same as if petitioner bought a tract of land from the State for cash and later resold it at a profit. In such case respondent contends petitioner would be subject

to the Federal income tax on its profit, and consequently must pay a tax on its income from these leases.

The State as early as 1913 (Act of April 9, 1913, Ch. 173, p. 409, 33rd Legislature), provided for leasing all public lands for the production of all kinds of minerals on a royalty basis. This was superseded by the 1917 Act heretofore referred to. Petitioner was the first to discover oil on University lands, and thereafter the potential returns to the State from the oil and gas on University lands so far overshadowed the prospective returns from other State lands and from other minerals that special legislation was passed dealing solely with oil and gas on University lands. As to them the Leasing Act of March 10, 1925, Ch. 71, p. 225, 39th Legislature, superseded the 1917 Act, which in turn was suspended by the Act of March 31, 1927, Ch. 249, p. 368, 40th Legislature, pending the determination of the Theisen case, and was repealed by the Act of January 11, 1929, Ch. 2, p. 6, 41st Legislature, and replaced by that of March 29, 1929, Ch. 282, p. 616, 41st Legislature. Copies of the 1917, 1925, 1927 and 1929 Acts are for convenience set out at pages *xii, xxvi, xxxiv, xxxvi* and *xxxix* of the Appendix, but the details of their provisions are not material.

In 1926 Theisen sued to compel Robison, the Land Commissioner, to issue him a permit to prospect for oil and gas under the 1917 Act. Robison refused on the ground the 1925 Act had repealed the 1917 Act as to oil and gas on University lands. The Board of Regents of the University intervened and contended that both Acts were invalid because of Article VII, Sec. 12, of the Constitution. The Supreme Court said:

"The principal question in the case is whether the

Acts of 1917 and 1925 violate Section 12 of Article 7 of the Constitution, which reads as follows:

"'The land herein set apart to the University shall be **sold** under such regulations, at such times, and on such terms as may be provided by law'."

The grounds of the attack were summarized by the court as follows:

"The two acts are mainly assailed on the ground that they provide for a permit or lease conferring on the permittee or lessee no greater right than a mere license, exercisable at the permittee's or licensee's option, to prospect for oil or gas, when the Constitution mandatorily requires the legislature to dispose of the University lands by **sale** only and forbids the grant of a mere optional license."

The legal grounds upon which the Supreme Court sustained the Leasing Acts may be summarized as follows: (1) The word "sold" as used in the Constitution should be given the meaning it had at common law. (2) For centuries the uniform method by which landowners converted their minerals into money has been the execution of leases with a royalty reserved. (3) The court in Benavides v. Hunt, 79 Tex. 383, 15 S. W. 396, Texas Company v. Daugherty, 107 Tex. 236, 176 S. W. 717, and Stephens County v. Mid-Kansas Oil & Gas Company, 113 Tex. 160, 254 S. W. 290, had held that in Texas an ordinary oil and gas lease operated to convey the title to the minerals in place immediately to the lessee, subject to reversion to the lessor on forfeiture of the lease, whereas some courts hold that title to the minerals remains in the lessor and does not pass to the lessee except as they are produced and reduced to actual possession. (4) As title to the minerals in place thus

passed to the lessee immediately, such a lease was a present conveyance of an interest in land, and, being such a conveyance, constituted a sale within the common law meaning of that term. (5) The leases authorized by the Leasing Acts had the same effect, the Supreme Court saying:

> "It is unthinkable to treat the ordinary lease as conveying minerals in place and to refuse to give that effect to the grants authorized by these Acts."

(6) These leases therefore constituted sales within the meaning of Section 12 of the Constitution.

Whether these leases are technically sales or not is wholly immaterial to the present case. The question involved is whether the Federal income taxes on petitioner's income interfere with the right and power of the State of Texas to convert its minerals, which are of no usable value while below the surface, into money. They are as great an interference with the exercise of this power by the State as the Oklahoma income taxes were with the efforts of the United States to develop the Indians' land for the Indians.

Respondent has in the lower courts argued that, under the latter part of the opinion in the Theisen case which stated that the State had sold all the oil and when it was thus appropriated by the lessee it formed no part of the University's permanent fund, these lessees were in no sense lessees but merely purchased all the oil and gas and resold it at a profit like any other public land bought from a State. The same is true in reference to any oil and gas lease. Although such leases usually provide the lessor's royalty shall be one-eighth of the actual oil produced, if the lessor demands the oil, or of the proceeds, the customary practice is

for the entire eight eighths to be sold and one-eighth of the proceeds remitted to the lessor. When the oil and gas are thus appropriated under the ordinary lease, the lessor has no further right, title or interest therein, but merely receives the proceeds of his royalty interest, just as the State here receives the proceeds of one-eighth of the oil and one-tenth of the gas.

The State may have parted with the legal title to the minerals in place, but if the terms of the leases are not carried out, they are subject to forfeiture in which event the title reverts to the State.

The true distinction between this case and that of an ordinary purchase and resale of State property has been pointed out in Weston v. City Council of Charleston, 27 U. S. (2 Peters) 449, 468:

> **"When lands are sold, no connexion remains between the purchaser and the government.** The lands purchased become a part of the mass of property in the country with no implied exemption from common burthens. All lands are derived from the general or particular government, and all lands are subject to taxation."

In Van Brocklin v. Tennessee, 117 U. S. 151, at 169:

> "And the reason why, after lands have been duly entered at the land office, and everything has been done to entitle the party to a patent, they have by long usage, confirmed by the decisions of this court, been considered before the patent is actually taken out, as subject to State taxation, is that the United States have nothing but the naked legal title, and the lands are in truth no longer public property, but have become private property."

In this case the State remains vitally connected with these leases and their production from day to day

through its royalties which depend solely on continued production. Instead of no connection remaining, the State's connection really in fact only commences as only upon the execution of these leases does it begin to realize upon its mineral wealth.

These leases are not sales in the meaning contended for by respondent. The Leasing Acts do not refer to the State as "seller" or "vendor" or to the lessee as "purchaser" or "vendee." Both in the Acts and in the opinion in the Theisen case they are continuously termed "lessor" and "lessee," and the leases are called "leases" and not "deeds" or "conveyances." The legislature had in mind and intended to create the usual relation existing between the ordinary oil and gas lessor and lessee.

The purpose of the State was not the same as in the usual case of sales of public land to homesteaders. In such cases it has no future interest in the lands sold and derives no further income therefrom. In these leases its primary end is benefit to itself through its reserved royalties. In the first Leasing Act of April 9, 1913 (33 Leg., Ch. 173, p. 409), it stated its purpose in section 1:

> "It is declared to be the policy of the State to open all such lands to mineral prospecting and development on a system providing for the payment into the State Treasury to the credit of the permanent free school, University, Asylum and other funds, of certain rents and royalties upon the gross output of any minerals or mineral product thereon."

This is evidenced by the emergency clause of the 1917 Act:

> "The fact that portions of the mineral statute are

> so incongruous and difficult of interpretation as to be almost inoperative and the fact that **a law clear in its terms and ample to secure the development of the State's mineral wealth is badly needed** * * * creates an emergency," etc.

It is further evidenced by the progress of legislation on the subject. Before the discovery of oil on State lands, leases could be obtained under the 1913 Act for ten cents an acre and a flat one-eighth royalty. Under the 1929 Act all leases are now let on competitive bidding, the bids including both the cash consideration and the amount of royalty the lessee is willing to pay.

As stated in Ambrosini v. United States, 187 U. S. 1, "They are not mere individual undertakings to secure a personal privilege, as suggested by the court below" but means for the development of the State's resources for its own benefit. In the last analysis the test can not be more clearly stated than it was in Railroad v. Peniston, 85 U. S. (18 Wall.) 5, 36:

> "It is, therefore, manifest that **exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax;** that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power."

Just as this court said in reference to national banks in Farmers & Mechanics National Bank v. Dearing, 91 U. S. 29, "of the degree of the necessity for creating them Congress is the sole judge," so here as to all questions concerning the creation of these leases and their terms, the relation to exist between the State and

its lessees, whether the title to all the minerals in place should be vested in the lessee subject to forfeiture or whether the State should retain title thereto until actually produced, the State was the sole judge.

This court has held exempt from State taxation varied forms of Federal instrumentalities. Patents on inventions, Long v. Rockwood, 277 U. S. 142; national banks, Owensboro National Bank v. Owensboro, 173 U. S. 664; Federal bonds and securities, Bank of Commerce v. New York City, 67 U. S. (2 Black) 620; Bank Tax Case, 69 U. S. (2 Wall.) 200; Home Savings Bank v. Des Moines, 205 U. S. 503; Miller v. Milwaukee, 272 U. S. 713; franchises to railroads, California v. Central Pacific R'y Co., 127 U. S. 1, and to telegraph companies, Telegraph Company v. Texas, 105 U. S. 460, Williams v. City of Talladega, 226 U. S. 404; sellers of gasoline to the Federal government, Panhandle Oil Company v. Knox, 277 U. S. 218, Graysburg Oil Company v. Texas, 278 U. S. 582. Petitioner is as important an agency of the State of Texas as any of these were of the United States.

This court has repeatedly refused to sustain an invalid tax merely because the State sought to give it a particular name.

> "Neither the State courts nor the legislatures, by giving the tax **a particular name** or by the use of some form of words, can take away our duty to consider its nature and effect." Galveston, Harrisburg & San Antonio R'y Co. v. Texas, 210 U. S. 217, 227.

See also Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292, 298; Lacoste v. Department of Conservation, 263 U. S. 545, 550.

"If, by varying the form—that is to say, if, by using one name for a tax instead of another, or imposing a tax in terms upon one subject when another is in reality aimed at—the substance and effect of the imposition may be changed, constitutional limitations upon powers of taxation would come to naught. * * *

"A liberal application of the foregoing principles, which find confirmation especially in the later decisions of this court, is essential to the preservation of the constitutional limitations imposed upon the taxing power of the States. Let it once be conceded that such limitations may be evaded by the adoption of **a delusive name** to characterize the tax or form of words to describe it, and the destruction of the vitality of these necessary safeguards will soon follow." The Macallen Company v. Massachusetts, 279 U. S. 620, 626, 631.

To sustain these taxes by calling petitioner's leases sales under the technical construction of the Texas Constitution is to resort to the use of a delusive name, to regard form of greater importance than substance, and to fail to make the proper application of the foregoing principles.

As heretofore stated respondent urged the Theisen case as a defense in both the District Court and the Circuit Court of Appeals. The District Court considered it and held it was not in point. The Circuit Court of Appeals referred to it, but its opinion demonstrates that it did not base its decision upon the holding in that case. If it did, we submit it was in error.

Point D.

By Section 27 of the 1917 Act the State of Texas did not grant permission to the United States to levy these

income taxes upon petitioner, its instrumentality, and these taxes may not be levied without the express consent of the State.

We have purposely delayed discussing the point upon which the Circuit Court of Appeals based its decision that petitioner was subject to the Federal income tax. That court so held on the sole ground that by Section 27 of the 1917 Act, which reads "Rights acquired under this Act shall be subject to taxation as is other property," the State gave its consent to the levy of these taxes by the Federal government. That court said:

> "The State of Texas by throwing the leases on University lands open to taxation generally, withdrew from the lessees all rights of exemption which might otherwise have existed."

We wanted this court to appreciate fully the importance of the principles involved before considering whether the State of Texas by this simple sentence waived all the benefits that would otherwise accrue to it. These principles are not embraced in any express provision of the Constitution but as this court said in M'Culloch v. Maryland,

> "There is no express provision for the case, but the claim has been sustained on a principle which so entirely pervades the Constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it without rending it into shreds."

If they are of so vital importance to both the Federal and the State governments, neither will be held to have waived them unless such waiver is expressed in

clear and unmistakable terms. This is the rule laid down by this court in numerous cases.

> "Whether the property of one of the States of the Union is taxable under the laws of that State depends upon the intention of the State as manifested by those laws. But whether the property of the United States shall be taxed under the laws of a State depends upon the will of its owner, the United States, and **no State can tax the property of the United States without their consent.**" Van Brocklin v. Tennessee, 117 U. S. 151, 175.

> "It follows then necessarily from these conclusions that the respective States would be wholly without power to levy any tax, either direct or indirect, upon the national banks, their property, assets or franchises, **were it not for the permissive legislation of Congress.**" Owensboro National Bank v. Owensboro, 173 U. S. 664, 668.

> "It is elementary that the Federal Government in all its activities is independent of State control. This rule is broadly applied. And, **without congressional consent,** no Federal agency or instrumentality can be taxed by State authority." Jaybird Mining Company v. Weir, 271 U. S. 609, 613.

In Bank of California v. Richardson, 248 U. S. 476, in speaking of the section of the United States Revised Statutes defining the taxes States could levy on national banks, this court said at page 483:

> "There is also no doubt from the section that it was intended to comprehensively control the subject with which it dealt and thus to furnish the exclusive rule governing State taxation as to the Federal agencies created as provided in the section. All possibility of dispute to the contrary is foreclosed by the decisions of this court."

Upon the same subject, in First National Bank v. Adams, 258 U. S. 362, this court said at page 364:

> "Section 5219 Revised Statutes (copied below) prescribes the full measure of the power of the several States to impose taxes upon national banking associations or their stockholders. **Any assessment not in conformity therewith is unauthorized and invalid.**"

In Heiner v. Colonial Trust Company, 275 U. S. 232, this court, in holding that Federal lessees of Indian lands, which it had previously held in the Oklahoma cases were exempt from State taxation, were subject to the Federal income tax, said on pages 234-235:

> "The power of the United States to tax the income is undoubted. It seems to us extravagant, in the face of the comprehensive language of the statute, to infer that Congress did not intend to exercise that power merely **because, in the absence of Congressional consent, it is one withheld from the States** or because the tax in terms imposed on others may have some economic effect upon the Indians themselves."

There is no reference whatever in Section 27 to Federal taxation. Direct taxes by the United States are the exception. In fact there have been no such direct ad valorem taxes on property since shortly after the Civil War.

In those instances where the Federal government has permitted States to tax its agencies it has been careful to express such consent clearly. In permitting State taxation of lessees of Federal lands it stated:

> "Provided, that nothing in this Act shall be construed or held to affect the rights of the States or other local authority to exercise any rights which they may have, including the right to levy and

collect taxes upon improvements, output of mines or other rights, property or assets of any lessee of the United States." Mid-Northern Oil Company v. Montana, 268 U. S. 45, 48.

In the case of national banks it has permitted certain classes of State taxes, but has in each case specified in detail exactly what taxes may be levied. Section 5219, United States Revised Statutes; United States Code, Title 12, Sec. 548. This court has consistently stricken down all State taxes that did not come strictly within the permitted classes. In speaking of Sec. 5219, this court said in Owensboro National Bank v. Owensboro, 173 U. S. 664, 669:

> "This section, then, of the Revised Statutes is the measure of power of a State to tax national banks, their property or their franchises. By its unambiguous provisions the power is confined to a taxation of the shares of stock in the names of the shareholders and to an assessment of the real estate of the bank. Any State tax therefore which is in excess of and not in conformity to these requirements is void."

In removing the exemption of minerals on Indian lands from State taxation it uses clear and unambiguous terms.

> "All minerals, including oil and gas, produced on or after April 26, 1931, from restricted allotted lands of members of the Five Civilized Tribes in Oklahoma, or from inherited restricted lands of full-blood Indian heirs or divisees of such lands, shall be subject to all State and Federal taxes of every kind and character the same as those produced from lands owned by other citizens of the State of Oklahoma." 45 Stats. 495, Ch. 517, Sec. 3.

That Section 27 was intended to apply only to State

taxation becomes even more apparent when the circumstances surrounding its passage are considered. It first appeared as Section 28 of the 1913 Leasing Act, as follows:

> "The rights acquired under this Act shall be subject to taxation as is other property after the owner shall have paid to the State the sums necessary to perfect his rights."

At that time and for several years afterward the exact nature of the interest of an oil and gas lessee in the leased premises was very unsettled in Texas. Some contended that, as oil and gas were fugitive substances, the lessor himself had no title to them while in place, and therefore a lease conveyed to the lessee no title or estate in the land or in the oil but only the right to explore and, if discovered, sever the oil from the land when produced. (See argument on pp. 226-227 in Texas Company v. Daugherty, 107 Tex. 226.) They contended that the lessee had no interest in land or real estate that was taxable under Revised Statutes 1911, Art. 7504, defining property subject to taxation as follows:

> "Real property, for the purpose of taxation, shall be construed to include the land itself, whether laid out in town lots or otherwise, and all the buildings, structures and improvements, or other fixtures of whatsoever kind thereon, and all the rights and privileges belonging or in anywise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same."

In 1913 the right of the State under this article to tax the lessee was being seriously contested by the Texas Company and other oil companies in the case of Texas Company v. Daugherty, 160 S. W. 129 (opinion by the Court of Civil Appeals of July 5, 1913), 107 Tex.

226, 176 S. W. 717 (opinion of the Supreme Court of May 21, 1915), just at the time Section 28 was placed in the Leasing Act of April 9, 1913. The intent of the legislature was to insure that lessees of State lands would pay the State and its subdivisions taxes based on the value of the leases the same as other property owners paid.

This is further illustrated by the contemporaneous House Bill No. 812 introduced in the Legislature on March 8, 1913. (The journal of the Texas Legislature seldom prints bills that are introduced and does not give any report of legislative debates or proceedings before committees. We have therefore had placed in the Record at page 69, a copy of this bill and the committee report, certified by the Secretary of State of Texas, the official custodian of the originals. A copy is inserted in the Appendix to this brief at page *xlix.*) This proposed to amend Article 7504 by adding the following:

> "also all leasehold interests whereby the lessee, grantee or licensee is authorized to mine and prospect for and take from lands, stone, granite, marble, fossils, minerals of any kind, including oil and gas."

The end sought was set forth in the emergency clause:

> "Sec. 2. The fact that the right of the State to tax leasehold interests in lands under which the lessee, grantee or licensee is permitted to prospect for and mine or take from said lands minerals, including oil and gas, is being disputed by the owners of said leasehold interests, and the State is being foreed to have litigation with such persons, therefore the necessity to render the law of this State upon said subject beyond cavil or the possibility of a doubt, creates an emergency, etc."

It is clear therefore the purpose of Section 28 of the 1913 Act was simply to insure beyond cavil or the possibility of a doubt that the State's lessees would pay State taxes on their leases.

Texas Company v. Daugherty was not decided by the Court of Civil Appeals until July 5, 1913, and by the Supreme Court until May 21, 1915. Even then the question was still unsettled, and it was not until the decision on June 30, 1923, in Stephens County v. Mid-Kansas Oil & Gas Company, 113 Tex. 160, 254 S. W. 290, that the Supreme Court definitely held that regardless of the granting clause of a lease, whether it is "grant, bargain, sell and convey" as in the Texas Company case, or "let and lease" as in the Stephens County case, or in any other words, the lessee's leasehold interest is a taxable estate in real property. As the law was still in this unsettled condition when the 1917 Leasing Act was passed, this Section 28 was carried forward as Section 27 to insure that the leases would be subject to State taxes. When it became finally settled by the Stephens County case in 1923, this provision was entirely omitted from the Leasing Acts of 1925 and 1929. This later action of the Legislature clearly shows it had in mind only State taxation when it inserted Sections 28 and 27, respectively, in the 1913 and 1917 Acts. When the end sought by the legislature in enacting those sections had been fully attained by the decisions in Texas Company v. Daugherty and Stephens County v. Mid-Kansas Oil & Gas Company, it dropped them from the Leasing Acts.

The Circuit Court of Appeals based its decision on the opinion of this court in Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575, stating that Section 27

was no broader than the provision in that case subjecting Indian lands to State taxation. For comparison we set the two sections out as follows:

Section 27 of Texas Act:	Section 4 of Federal Act:
"Rights acquired under this Act shall be subject to taxation as is other property."	"All land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes."

The opinion in that case reviews the circumstances surrounding its passage and points out that Congress intended this to relate to State taxation as part of an established program of gradually converting the Indians into an independent and self-reliant people by granting them the privileges of citizens and developing their sense of responsibility by placing on them the burdens of citizenship. As this court said in that opinion:

> "In this (that is, the Act of 1908), as in other Indian legislation, opportunity is afforded for their emancipation by imposing upon them duties as well as giving them the privileges of citizens and property owners, **including the duty to pay taxes.**" (Page 580.)

Furthermore the provision of Section 4 was inserted at the request of Oklahoma for the specific purpose of allowing it to tax these lands, as was pointed out at page 581:

> "This section was adopted in response to representations that the revenue of the State of Okla-

homa was insufficient for State purposes, that large areas of lands within the State allotted to Indians were exempt from taxation as agencies of the Federal Government and that Indian citizens were enjoying the benefit of local government without taxation."

The end sought by Congress in enacting Section 4 was to make these Indian lands expressly subject to State taxation. The end sought by Texas in enacting Section 27 was to insure the leases being subject to taxation by the State and its subdivisions with no thought as to Federal taxation. Therefore that case does not support the Circuit Court of Appeals in its construction of Section 27.

The mere fact that the leases are subject to State taxation does not take away their exemption from Federal taxation. The Texas statutes, Article 7147, R. S. 1925, provide that "bonds" and "all public stock and securities" shall be subject to taxation, but the Federal government may not tax the income therefrom. Pollock v. Farmers Loan & Trust Company, 157 U. S. 429. The Federal income tax law applies to Federal employees, but this does not allow a State to tax them.

If the Circuit Court of Appeals were correct, this anomalous result would follow. If three lessees held leases on three adjoining tracts of University land, one under the 1917 Act, one under the 1925 Act and the other under the 1929 Act, the 1917 lessee would pay the Federal taxes but the other two would not as their Acts do not contain Section 27 of the 1917 Act. It is upon that section the Circuit Court of Appeals sustained these taxes. The Legislature of this State never intended such an unequal burden of taxation to be placed on the State's lessees.

It is submitted the Circuit Court of Appeals was in error in construing Section 27 as authorizing the collection of these Federal taxes.

Point E.

Section 27 of the 1917 Act was repealed on March 10, 1925, before the taxes involved in this cause were levied or became due and payable.

The first taxes sued for were paid for the fiscal year ending June 30, 1925. (R. 4.) The income tax return for that year was not due to be filed until September 15, 1925. Sec. 227 (*a*) of the Revenue Acts of 1924 and 1926. The 1925 Leasing Act was approved and became effective on March 10, 1925.

The 1917 Act dealt with University lands and all other lands of the State. The 1925 Act dealt solely with University lands and as to such lands repealed the 1917 Act. Theisen v. Robison, 117 Tex. 489, 512.

In The Paquete Habana, 175 U. S. 677, this court said at page 685:

> "And it is a well settled rule in the construction of statutes, often affirmed and applied by this court, that, 'even where two Acts are not in express terms repugnant, yet if the latter Act **covers the whole subject of the first, and embraces new provisions, plainly showing that it was intended as a substitute for the first Act,** it will operate as a repeal of that Act.' United States v. Tynen, 11 Wall. 88, 92; King v. Cornell, 106 U. S. 395, 396; Tracy v. Tuffly, 134 U. S. 206, 223; Fisk v. Henarie, 142 U. S. 459, 468; District of Columbia v. Hutton, 143 U. S. 18, 27; United States v. Healey, 160 U. S. 136, 147."

In St. Louis & Southwestern Railway Company v. J. A. Kay Company, 85 Tex. 558, 22 S. W. 665, the court said at page 560:

> "In Rogers v. Watrous (8 Tex. 62), *supra*, Judge Wheeler says: 'A subsequent statute revising the subject-matter of a former one, and evidently intended as a substitute for it, although it contains no express words to that effect, must operate to repeal the former to the extent to which its provisions are revised and supplied. So, though a subsequent statute be not repugnant in its provisions to a former one, yet if it was clearly intended to prescribe the only rules which should govern, it repeals the prior statute'."

See also Tracy v. Tuffly, 134 U. S. 206, 223; First National Bank v. Lee County Cotton Oil Company, 274 S. W. 127 (Tex. Com. of Appeals).

The 1925 Act covered the entire subject of oil and gas leases on University lands, and thereafter all such leases were granted subject to its provisions and not those of the 1917 Act. It is true such repeal could not affect the rights granted by the State to lessees under prior Acts, and the 1925 Act did not attempt to cancel such leases. However, it did repeal the provision of Section 27 dealing with taxation. There was no reason for a special provision like Section 27 to remain applicable to 1917 leases for State taxation purposes, while 1925 leases were subject to State taxes only under the general taxing laws.

Furthermore, as heretofore pointed out, if Section 27 has the effect attributed to it by the Circuit Court of Appeals, lessees holding under the 1917 Act would be subject to the Federal income taxes while those under the 1925 and 1929 Acts would not. The Legislature

never intended such a manifestly unequal burden of taxation to result. It would be contrary to the general policy of all governments that taxes shall be equal and uniform, and would violate the express provision of Article VIII, Section 1, of the Texas Constitution that

"Taxation shall be equal and uniform."

We submit that Section 27 was not in effect when the taxes in this cause were levied and collected.

Point F.

It is immaterial that the State of Texas is not a party to this cause and is not affirmatively asserting that petitioner is exempt from the Federal income tax.

The Circuit Court of Appeals is not clear in its opinion but seems to attach some importance to the fact that the State is not a party and has not sought affirmatively to exempt its lessees from these taxes.

In all the cases before this court it has been the instrumentality that has resisted the taxes and not the government creating it. In none of the cases has the United States or a State been a party. In fact the refund of the taxes is to be made to petitioner and the State is neither a necessary nor a proper party to this cause. The State of Texas is a party to this cause through petitioner. It is representing the interests of the State and is asserting its claims as the representative of the State. The State is not required to assert affirmatively the exemption claimed by petitioner. On the other hand the exemption stands until it is clearly and unmistakably waived by the State.

Conclusion.

We submit that this case is in principle identical with that of Gillespie v. Oklahoma, 257 U. S. 501, and that the words of this court in that case

> "'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon income from the leases is not long,"

are strictly applicable to the leases of petitioner and its income therefrom.

It is respectfully submitted that the petition should be granted.

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APPENDIX A

Resolutions Resulting in Annexation of Texas.

The following is a copy of the joint resolution of the Congress of the United States, 5 Stats. 797:

No. 8. Joint Resolution for annexing Texas to the United States.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That Congress doth consent that the territory properly included within, and rightfully belonging to the Republic of Texas, may be erected into a new State, to be called the State of Texas, with a republican form of government, to be adopted by the people of said Republic, by deputies in convention assembled, with the consent of the existing government, in order that the same may be admitted as one of the States of this Union.

2. And be it further resolved, That **the foregoing consent of Congress is given upon the following conditions, and with the following guarantees,** to wit: First, Said State to be formed, subject to the adjustment by this government of all questions of boundary that may arise with other governments; and the Constitution thereof, with the proper evidence of its adoption by the people of said Republic of Texas, shall be transmitted to the President of the United States, to be laid before Congress for its final action, on or before the first day of January, one thousand eight hundred and forty-six. Second: **Said State,** when admitted into the Union, after ceding to the United States, all public edifices, fortifications, barracks, ports and harbors, navy and navy-yards, docks, magazines, arms, ar-

maments, and all other property and means pertaining to the public defense belonging to said Republic of Texas, shall retain all the public funds, debts, taxes, and dues of every kind, which may belong to or be due and owing said republic; and **shall also retain all the vacant and unappropriated lands lying within its limits, to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after discharging said debts and liabilities, to be disposed of as said State may direct;** but in no event are said debts and liabilities to become a charge upon the Government of the United States. Third. New States, of convenient size, not exceeding four in number, in addition to said State of Texas, and having sufficient population, may hereafter, by the consent of said State, be formed out of the territory thereof, which shall be entitled to admission under the provisions of the Federal Constitution. And such States as may be formed out of that portion of said territory lying south of thirty-six degrees thirty minutes north latitude, commonly known as the Missouri compromise line, shall be admitted into the Union with or without slavery, as the people of each State asking admission may desire. And in such State or States as shall be formed out of said territory north of said Missouri compromise line, slavery, or involuntary servitude (except for crime), shall be prohibited.

3. And be it further resolved, That if the President of the United States shall in his judgment and discretion deem it most advisable, instead of proceeding to submit the foregoing resolution to the Republic of Texas, as an overture on the part of the United States for admission, to negotiate with that Republic; then,

Be it resolved, That a State, to be formed out of the present Republic of Texas, with suitable extent and boundaries, and with two representatives in Congress, until the next apportionment of representation, shall be admitted into the Union, by virtue of this act, on an equal footing with the existing States, as soon as the terms and conditions of such admission, and the cession of the remaining Texian territory to the United States shall be agreed upon by the Governments of Texas and the United States: And that the sum of one hundred thousand dollars be, and the same is hereby, appropriated to defray the expenses of missions and negotiations, to agree upon the terms of said admission and cession, either by treaty to be submitted to the Senate, or by articles to be submitted to the two houses of Congress, as the President may direct.

APPROVED, March 1, 1845.

* * * * * * *

After the adoption of this resolution, the Congress of the Republic of Texas adopted the following resolution set forth in 2 Gammel's Laws of Texas, page 1200.

Joint Resolution.

Giving the consent of the existing Government to the annexation of Texas to the United States.

Whereas, the Government of the United States hath proposed the following terms, guarantees, and conditions, on which the People and Territory of the Republic of Texas may be erected into a new State, to be called the State of Texas, and admitted as one of the States of the American Union, to wit:

"Resolved by the Senate and House of Representa-

tives of the United States of America in Congress assembled, That Congress doth consent that the Territory properly included within and rightfully belonging to the Republic of Texas may be erected into a new State, to be called the State of Texas, with a Republican form of Government, to be adopted by the people of said Republic, by deputies in Convention assembled, with the consent of the existing Government, in order that the same may be admitted as one of the States of this Union.

"2. And be it further resolved, That the foregoing consent of Congress is given upon the following conditions, and with the following guarantees, to wit:

"First. Said State to be formed subject to the adjustment by this Government of all questions of boundary that may arise with other Governments, and the Constitution thereof, with the proper evidence of its adoption, by the people of said Republic of Texas, shall be transmitted to the President of the United States, to be laid before Congress for its final action, on or before the first day of January, one thousand eight hundred and forty-six.

"Second. Said State when admitted into the Union after ceding to the United States all public edifices, fortifications, barracks, ports and harbors, navy and navy-yards, docks, magazines, arms, armaments and all other property and means pertaining to the public defence, belonging to the said Republic of Texas, shall retain all the public funds, debts, taxes, and dues of every kind which may belong to or be due and owing said Republic; and shall also retain all the vacant and unappropriated lands lying within its limits, to be applied to the payment of the debts and liabilities of said

Republic of Texas, and the residue of said lands, after discharging said debts and liabilities, to be disposed of as said State may direct; but in no event are said debts and liabilities to become a charge upon the Government of the United States.

"THIRD. New States of convenient size, not exceeding four in number, in addition to said State of Texas, and having sufficient population, may hereafter, by the consent of said State, be formed out of the territory thereof, which shall be entitled to admission under the provisions of the Federal Constitution. And such States lying south of thirty-six degrees thirty minutes north latitude, commonly known as the Missouri compromise line, shall be admitted into the Union, with or without slavery, as the people of each State asking admission may desire. And in such State or States as shall be formed out of said territory north of said Missouri compromise line, slavery or involuntary servitude except for crime shall be prohibited."

And whereas, by said terms, the consent of the existing government of Texas is required—Therefore,

Be it resolved by the Senate and House of Representatives of the Republic of Texas, in Congress assembled, That the Government of Texas doth consent, that the People and Territory of the Republic of Texas, may be erected into a new State, to be called the State of Texas, with a Republican form of Government, to be adopted by the people of said Republic, by Deputies in Convention assembled, in order that the same may be admitted as one of the States of the American Union, and **said consent is given on the terms, guarantees and conditions set forth in the Preamble to this Joint Resolution.**

SEC. 2. Be it further resolved, That, the Proclamation of the President of the Republic of Texas, bearing date May fifth, eighteen hundred and forty-five, and the election of Deputies to set in Convention, at Austin on the fourth day of July next for the adoption of a Constitution for the State of Texas, had in accordance therewith, hereby receives the consent of the existing Government of Texas.

SEC. 3. Be it further resolved, That, the President of Texas is hereby requested immediately to furnish the Government of the United States, through their accredited Minister near this Government, with a copy of this Joint Resolution; also to furnish the Convention to assemble at Austin, on the fourth of July next, a copy of the same—And the same shall take effect from and after its passage.

JOHN M. LEWIS,
Speaker of the House of Representatives
K. L. ANDERSON,
President of the Senate.

Approved, June 23, 1845.

ANSON JONES.

Thereafter the Convention of the People of the Republic of Texas adopted a similar resolution on July 4, 1845. This resolution is practically identical with the foregoing and is not here copied. It may be found in 2 Gammel's Laws of Texas, page 1228.

* * * * *

After these resolutions had been adopted, the Congress of the United States adopted the following resolution formally admitting Texas into the Union, which resolution is set forth in 9 United States Statutes at Large, page 108.

(No. 1.)—Joint Resolution for the Admission of the State of Texas into the Union.

Whereas the Congress of the United States, by a joint resolution approved March the first, eighteen hundred and forty-five, did consent that the territory properly included within, and rightfully belonging to, the Republic of Texas, might be erected into a new State, to be called THE STATE OF TEXAS, with a republican form of government, to be adopted by the people of said republic, by deputies in convention assembled, with the consent of the existing government, in order that the same might be admitted as one of the States of the Union; which consent of Congress was given upon certain conditions specified in the first and second sections of said joint resolution; and whereas the people of the said Republic of Texas, by deputies in convention assembled, with the consent of the existing government, did adopt a Constitution, and erect a new State with a republican form of government, and, in the name of the people of Texas, and by their authority, did ordain and declare that they assented to and accepted the proposals, conditions, and guaranties contained in said first and second sections of said resolution; and whereas the said Constitution, with the proper evidence of its adoption by the people of the Republic of Texas, has been transmitted to the President of the United States and laid before Congress, in conformity to the provisions of said joint resolution:

Therefore—

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the State of Texas shall be one, and is hereby declared to be one, of the United States of America,

and admitted into the Union on an equal footing with the original States in all respects whatever.

SECTION 2. And be it further resolved, That until the representatives in Congress shall be apportioned according to an actual enumeration of the inhabitants of the United States, the State of Texas shall be entitled to choose two representatives.

APPROVED December 29, 1845.

APPENDIX B

Sections 10, 11, 12, 13, 14 and 15 of Article VII of the Constitution of the State of Texas, Pertaining to the University of Texas.

SEC. 10. The legislature shall, as soon as practicable, establish, organize and provide for the maintenance, support and direction of a university of the first class, to be located by a vote of the people of this State, and styled, "The University of Texas," for the promotion of literature, and the arts and sciences, including an agricultural and mechanical department.

SEC. 11. In order to enable the legislature to perform the duties set forth in the foregoing section, it is hereby declared that all lands and other property heretofore set apart and appropriated for the establishment and maintenance of the University of Texas, together with all the proceeds of sales of the same, heretofore made or hereafter to be made, and all grants, donations and appropriations that may hereafter be made by the State of Texas, or from any other source, shall constitute and become a permanent university fund. And the same as realized and received into the treasury of the State (together with such sum belonging to the fund, as may now be in the treasury), shall be invested in bonds of the State of Texas, if the same can be obtained; if not, then in United States bonds; and the interest accruing thereon shall be subject to appropriation by the legislature to accomplish the purpose declared in the foregoing section; provided, that the one-tenth of the alternate sections of the lands

granted to railroads, reserved by the State which were set apart and appropriated to the establishment of the University of Texas, by an Act of the Legislature of February 11, 1858, entitled "An Act to establish 'the University of Texas'," shall not be included in, or constitute a part of, the permanent university fund.

SEC. 12. The land herein set apart to the university fund shall be sold under such regulations, at such times, and on such terms as may be provided by law; and the legislature shall provide for the prompt collection, at maturity, of all debts due on account of university lands heretofore sold, or that may hereafter be sold, and shall in neither event have the power to grant relief to the purchasers.

SEC. 13. The Agricultural and Mechanical College of Texas, established by an Act of the Legislature, passed April 17, 1871, located in the County of Brazos, is hereby made and constituted a branch of the University of Texas, for instruction in agriculture, the mechanic arts, and the natural sciences connected therewith. And the legislature shall, at its next session, make an appropriation, not to exceed forty thousand dollars, for the construction and completion of the buildings and improvements and for providing the furniture necessary to put said college in immediate and successful operation.

SEC. 14. The legislature shall, also, when deemed practicable, establish and provide for the maintenance of a college or branch university for the instruction of the colored youths of the State, to be located by a vote of the people; provided, that no tax shall be levied, and no money appropriated out of the general revenue, either for this purpose or for the establishment and erection of the buildings of the University of Texas.

SEC. 15. In addition to the lands heretofore granted to the University of Texas, there is hereby set apart and appropriated for the endowment, maintenance, and support of said university and its branches, one million acres of the unappropriated public domain of the State; to be designated and surveyed as may be provided by law; and said lands shall be sold under the same regulations, and the proceeds invested in the same manner, as is provided for the sale and investment of the permanent university fund, and the legislature shall not have the power to grant any relief to the purchasers of said lands.

APPENDIX C

Act of March 16, 1917—35th Legislature, P. 158.
Chapter 83.

An Act to Amend Chapter 173 *of the Regular Session of the Thirty-third Legislature approved April* 9, 1913, *relating to the prospecting for and the development of the minerals and other substances in the public land, public islands and public waters and river beds and channels owned by the State, and in the unsold land belonging to the public free school fund, the University fund and the several asylums fund and in such of said land as has heretofore been sold or may hereafter be sold with the reservation of the minerals and other substances therein to the fund to which the land belongs; providing the royalty and other sums and compensation to be paid to the State and owners of the surface, and appropriating the proceeds to certain funds; providing for ingress and egress; providing one may pay cash for mineral claims, and obtain patents and change former claims to rights under this Act; providing for the adoption of rules and regulations by the Commissioner of the General Land Office, repealing the remaining portion of this said Chapter* 173 *which may not be amended and all other statutes in conflict with this Act, and declaring an emergency.*

Be It Enacted By the Legislature of the State of Texas:

SECTION 1. All of Chapter 173 of the Regular Session of the Thirty-third Legislature approved April 9, 1913, shall be so amended as to hereafter read as follows:

SECTION 1. All public school, University and Asylum land and other public lands, fresh water lakes, river beds and channels, islands, bays, marshes, reefs and

salt water lakes belonging to the State and all lands which may hereafter be so owned and all of said lands which have heretofore been sold or disposed of by the State or by its authority with a reservation of minerals or mineral rights therein as well as all lands which may hereafter be sold with the reservation of minerals or mineral rights therein, and lands purchased with a relinquishment of the minerals therein, shall be included within the provisions of this Act and shall be open to the prospecting for and the development of the minerals and substances known as gold, silver, cinnebar, lead, tin, copper, zinc, platinum, radio-active minerals, tungsten, ores of aluminum, coal, lignite, iron ore, kaolin fire clays, barite, marble, petroleum, natural gas, gypsum, nitrates, asbestos, marls, salt, onyx, turquoise, mica, guano, bismuth and bismuth bearing minerals, asphalt, potash compounds, sulphur, graphite, magnesia, fuller's earth, molybdenum and molybdenum bearing minerals upon the terms and conditions provided in this Act.

SECTION 2. Any person or association of persons, corporate or otherwise, being a citizen of the United States or having declared an intention of becoming such, desiring to obtain the right to prospect for and develop the minerals and substances named above that may be in any of the areas included herein may do so under the provisions of this Act together with such rules and regulations as may be adopted by the Commissioner of the General Land Office relative thereto and necessary for the execution of the purposes of this Act.

SECTION 3. One desiring to obtain the right to prospect for and develop petroleum oil and natural gas that may be in any of the surveyed areas included

herein shall file with the County Clerk an application in writing giving a designation of same sufficient to identify it. The county clerk shall, upon receipt of one dollar as a filing fee, file and record the application and note the same on his record of surveys opposite the entry of the proper survey, giving the time of filing. When one has obtained four sections or that equivalent eligible to be embraced in one permit such applicant shall not obtain any more land within two miles thereof, but if one obtains less than four sections eligible to be embraced in one permit such one may obtain such additional area within two miles of the other area as will equal four sections. One shall not obtain more than one thousand acres within one mile of a well producing petroleum.

SECTION 4. One desiring to obtain the right to prospect for and develop petroleum and natural gas in any of the State's unsurveyed areas named in this Act shall file with the county surveyor an application in writing for each area applied for, giving a designation of same sufficient to identify it, but such area shall not exceed 2560 acres. Upon receipt of one dollar filing fee the surveyor shall file and record the application.

SECTION 5. When the Commissioner receives an application that was filed with the county Clerk or an application that was filed with the surveyor and the field notes and plat, one dollar filing fee and ten cents per acre for each acre applied for and a sworn statement by the applicant showing what interest he has in other permit, lease or patent issued under this Act and in good standing, he shall file same, and if upon examination the application or the application and field notes are found correct and the area applied for is within

the provisions of this Act the Commission shall issue to the applicant or his assignee a permit conferring upon him an exclusive right to prospect for and develop petroleum and natural gas within the designated area for a term not to exceed two years.

SECTION 6. Before the expiration of six months after the date of the permit the owner thereof shall in good faith begin actual work necessary to the physical development of said area and if petroleum or natural gas is not sooner developed in commercial quantities the owner or manager shall, within thirty days after the expiration of one year from the date of the permit, file in the General Land Office a sworn statement supported by two disinterested credible persons that such actual work was begun within the first six months aforesaid and that a bona fide effort to develop the said area was made during the six months preceding the filing of the statement and showing what work was done and expenditures incurred and whether or not petroleum or natural gas had been discovered in commercial quantities. A failure to file the statement herein provided for within the time specified or the filing of a statement untrue or false in material matters shall subject the permit to forfeiture and the termination of the rights of the owner. The owner of a permit shall not take, carry away or sell any petroleum or natural gas before obtaining a lease therefor; provided, such quantity as may be necessary for the continued development of the area before obtaining a lease may be used without accounting therefor.

SECTION 7. If at any time within the life of a permit one should develop petroleum or natural gas in commercial quantities the owner or manager shall file in

the General Land Office a statement of such development within thirty days thereafter, and thereupon the owner of the permit shall have the right to lease the area included in the permit upon the following conditions:

1. An application and a first payment of two dollars per acre for a lease of the area included in the permit shall be made to the Commissioner of the General Land Office within thirty days after the discovery of petroleum or natural gas in commercial quantities.

2. Upon the payment of two dollars per acre for each acre in the permit a lease shall be issued for a term of ten years or less, as may be desired by the applicant, and with the option of a renewal or renewals for an equal or shorter period, and annually after the expiration of the first year after the date of the lease the sum of two dollars per acre shall be paid during the life of the lease; and in addition thereto the owner of the lease shall pay a sum of money equal to a royalty of one-eighth of the value of the gross production of petroleum. The owner of a gas well shall pay a royalty of one-tenth of the value of the meter output of all gas disposed of off the premises.

3. The royalties shall be paid to the State through the Commissioner of the General Land Office at Austin, monthly during the life of the lease. All payments shall be accompanied by the sworn statement of the owner or manager or other authorized agent showing the amount produced since the last report and the market value of the output and a copy of all pipe line receipts, tank receipts, gauge of all tanks into which petroleum may have been run, or other checks and memoranda of amount put out or into pipe lines or

tanks or pools. The books and accounts, the receipts and discharges of all pipe lines, tanks and pools and gas lines and gas pipes and all other matters pertaining to the production, transportation and marketing of the output shall be open to the examination and inspection at all times by the Commissioner of the General Land Office or his representative or any other person authorized by the Governor or Attorney General to represent the State. The value of any unpaid royalty and any sum due the State under this Act upon any lease shall become as prior lien upon all production produced upon the leased areas and the improvements situated thereon to secure the payment of any royalty and any sum due the State arising under the operation of any portion of this Act.

4. The permit or lease shall contain the terms upon which it is issued including the authority of the Commissioner to require the drilling of wells necessary to offset wells drilled upon adjacent private land, and such other matters as the Commissioner may deem important to the rights of the applicant or the State.

SECTION 8. In the event the surface of an area included within the operations of this Act has heretofore been or may hereafter be acquired by one prior to the filing of an application under the provisions herein such area shall nevertheless be subject to prospect and lease as provided herein but the owner of the permit or lease shall pay to the owner of the surface annually in advance during the life of the permit or lease, ten cents per acre and the sum so paid and accepted by the surface owner shall be full compensation for all damages to the surface.

SECTION 9. Every person or association of persons,

corporate or otherwise, applying for a permit, lease or patent shall file with the application a sworn statement showing what interest the applicant has in any other permit or lease issued by the State and in good standing at the date of the statement.

Coal and Lignite.

(Sections 10-11-12-13-14 and 15 deal solely with the development of minerals other than oil and gas and these sections are not here copied.)

General Provisions.

SECTION 16. The general provisions in this and the following section shall apply to all the foregoing provisions so far as applicable.

Surveyed land within the meaning of this Act shall include all tracts for which there are approved field notes on file in the General Land Office and eighty acre tracts and multiples thereof of such surveys.

Unsurveyed areas within the meaning of this Act include all areas for which there are no approved field notes on file in the General Land Office.

All applications for surveyed land shall be filed with the clerk of the county in which the tract or a portion thereof is situated or with the clerk of the county to which such county may be attached for judicial purposes and accompanied by one dollar filing fee, and it shall be filed in the General Land Office within thirty days after it was filed with the county clerk and accompanied by one dollar filing fee.

All applications for unsurveyed areas shall be filed with the county surveyor, or his deputy, of the county

in which the area or a part thereof is situated, accompanied by one dollar filing fee, but if such county has no surveyor then the application shall be filed with the clerk of the proper county and by him recorded in the surveyor's records, and in that event the area may be surveyed by the surveyor of the nearest county as now provided by law. The area shall be surveyed within ninety days and the application, field notes and plat shall be filed in the General Land Office, accompanied by a filing fee of one dollar, within one hundred days after the date of the filing of the application.

The payment per acre required to be made before the issuance of a permit shall be paid annually thereafter during the life of the permit or lease.

A separate written application shall be made for the area desired in a permit. No permit, lease or patent shall embrace the area in two or more applications.

No application, permit, lease or patent shall embrace a divided area.

Whole tracts of surveyed land may be applied for as a whole or in eighty-acre tracts or multiples thereof without furnishing field notes therefor.

A duplicate of every permit and lease shall be kept in the General Land Office.

The area in each permit shall be developed independently of other areas.

When one desires a lease or patent any one or more whole tracts in the permit may be abandoned by relinquishment filed in the General Land Office as herein provided and thereupon obtain a lease or patent upon the remaining area; provided such remaining area is in a solid body,

An owner may relinquish a permit or lease at any time by having the deed of relinquishment acknowledged, recorded by the proper county clerk and filed in the General Land Office accompanied by one dollar filing fee. The Commissioner of the General Land Office shall mail notice to the proper County Clerk of the filing of the relinquishment and when said notice has had time through due course of mail to reach said clerk the area shall be subject to applications as in the first instance.

SECTION 17. The proceeds arising from activities under this Act which affects land belonging to the public free school fund, the permanent University fund and the permanent fund of the several asylums shall be credited to the permanent fund of said institutions and the proceeds arising from the activities affecting other areas shall be credited to the Game, Fish and Oyster Fund.

SECTION 18. The owner of a file or permit or lease under any provision of this Act may sell same and the rights secured thereby at any time, also fix a lien of any kind thereon to any person, association of persons, corporate or otherwise, who may be qualified to receive a permit or lease in the first instance; provided, the instrument evidencing the sale or lien shall be recorded in the county where the area or part thereof is situated or in the county to which such county may be attached for judicial purposes and same shall be filed in the General Land Office within sixty days after the date thereof accompanied with a filing fee of one dollar, and if not so filed the contract evidenced by said instrument shall be void and the obligations therein assumed shall not be enforceable; provided further, a sublease contract need not be filed in the General Land Office.

SECTION 19. If a permit or lease should be issued upon

a statement by the applicant which is false or untrue in material matters, or should the owner of a permit fail or refuse to begin in good faith the work necessary to the development of the area within the time required, or should the owner of a permit fail or refuse to proceed in good faith and with reasonable diligence in a bona fide effort to develop an area included in his permit after having begun the development, or should the owner of a permit fail or refuse to apply for a lease within the prescribed time, or should the owner of a lease fail or refuse to proceed in good faith and with reasonable diligence and in a bona fide effort to develop, operate and put out the mineral or other substance at any time during the life of the lease, or should the owner of a lease fail or refuse to make proper remittance in payment of royalty or other payments or fail or refuse to make the proper statement, or fail to furnish the required evidence of the output and market value and material matters relating thereto when requested, or fail to make the annual payment on the area when requested so to do the permit or lease, as the case may be, shall be subject to forfeiture, and when the Commissioner is sufficiently informed of the facts which subject the permit or lease to forfeiture he may declare same forfeited by proper entry upon the duplicate permit or lease kept in the General Land Office. When forfeiture has been declared a notice of that fact shall be mailed to the proper county clerk and the area shall be subject to the application of another than the forfeiting owner when the notice has had time to reach the county clerk through due course of mail; provided, the Commissioner may exercise large discretion in the matter of requiring one to develop gas wells, and provided further, that all for-

feitures may, within the discretion of the Commissioner be set aside and all rights reinstated before the rights of another intervene.

SECTION 20. An owner of any claim for any mineral or substance included in this Act may fell and remove for building or mining purposes any timber upon any of the unsold areas included within this Act, and shall also have the right to occupy within the limits of his application, permit or lease, so much of the surface thereof as may be necessary for the development of the minerals and substances therein, and shall have the right of ingress, to and from the area embraced in the file, permit, lease or patent. Ten cents per acre shall be paid to the owner of the surface and when accepted by the owner, it shall be deemed full compensation for such damages as may be occasioned to the surface through the occupancy and operation by the owner of the permit, lease or patent.

SECTION 21. Neither the filing of an application under any provision of this Act nor the issuance of a permit or lease on any of the unsold land included herein shall prevent the sale of the surface without the minerals and in case of such sale subsequent to the posting of any notice or the filing of an application the purchaser shall not be entitled to the ten cents per acre that is provided for owners of the surface at the time of filing nor shall such owner be entitled to any damages that may be occasioned by the working of any area.

SECTION 22. All development in water or on islands, marshes, reefs or river beds and channels shall be done under such regulations as will prevent the pollution of the water and for the prevention of such pollution the Commissioner of the General Land Office may call upon

the Game, Fish and Oyster Commissioner for assistance in the adoption and enforcement of rules and regulations for the protection of the waters from such pollution. The Commissioner of the General Land Office, may cancel a claim, location, file, permit or lease or patent for a failure or refusal of the owner to comply with such rules and regulations as may be adopted.

SECTION 23. Should any mineral or substance within the provisions of this Act, other than those included in the permit or lease under which one is operating, be discovered while the area is being worked for the minerals and substances embraced in such permit or lease, the owner thereof shall have a preference right for sixty days after such discovery in which to file on the area allowed one for such mineral or other substance by complying with the provisions of this Act relating to the mineral or substance so discovered, but shall not be required to pay either of the additional ten cents per acre to the State or the owner of the surface, and the remaining portion of said area shall be subject to the application of others in the same manner as if there were no pre-existing file thereon.

SECTION 24. If the owner of a claim upon any mineral or other substance named in this Act, other than petroleum and natural gas which has been acquired under any previous statute, should desire to accept the provisions of this Act and operate hereunder he may do so by filing a declaration to that effect in the General Land Office together with the payment required in the particular instance and obtain a permit or lease by complying with the provisions hereof relating thereto. The rights under such acceptance shall begin from the date the declaration is filed and the owner shall have the

same rights thereafter as is accorded those who make original filings under this Act.

SECTION 25. At any time during the life of a permit but prior to accepting a lease upon any area for any mineral or other substance included within the provisions of this Act, except petroleum and natural gas, the owner of a permit may elect to pay one hundred dollars per acre for the area embraced in his permit and obtain under the rules governing the issuance of patents to land, a patent for all the minerals that may be in such area except petroleum and natural gas in lieu of the payment of the royalty as provided in this Act; provided, however, one shall pay the prescribed royalty on all minerals and substances put out and disposed of while developing the area prior to obtaining a lease or patent.

SECTION 26. The Commissioner of the General Land Office shall have the general supervision of all matters necessary for the proper administration of this Act and he is authorized to adopt rules and regulations and to alter or amend them from time to time as he may deem necessary for the protection of the interests involved and not inconsistent with the provisions herein.

SECTION 27. Rights acquired under this Act shall be subject to taxation as is other property.

SECTION 28. Chapter 173 approved April 9, 1913, and all other laws and parts of laws in conflict with this Act are hereby repealed.

SECTION 29. The fact that portions of the mineral statute are so incongruous and difficult of interpretation as to be almost inoperative and the fact that a law clear in its terms and ample to secure the development of the State's mineral wealth is badly needed

and the near approach to the close of the session creates an emergency and an imperative public necessity exists that the constitutional rule which requires bills to be read on three several days in each house be suspended and that this take effect from and after its passage and it is so enacted.

APPROVED March 16, 1917.

APPENDIX D

ACT OF MARCH 10, 1925, CHAPTER 71, PAGE 225, REGULAR SESSION, 39TH LEGISLATURE

An Act for the sale of oil and gas leases on university land and to provide for the extension of the time for the expiration of oil and gas permits heretofore issued on university land and the issuance of leases thereon without the payment of any further sum except royalty, and declaring an emergency.

Be It Enacted By the Legislature of the State of Texas:

SECTION 1. That all university land now unsold and all of said land that has heretofore been sold with reservation of the minerals therein and that which may hereafter be sold with reservation of the minerals therein, whether known or unknown, shall be included in this Act and leases thereon conferring upon persons, firms and corporations the right to develop the oil and natural gas that may be in said land shall be subject to sale by the Commissioner of the General Land Office in accordance with the provisions of this Act and under such rules and regulations as may be adopted by said commissioner as may be necessary to the proper execution of its purposes; provided, oil and gas permits and leases outstanding shall not be affected by this Act except as provided in Section 14 hereof.

SEC. 2. Sales of oil and gas leases on the lands included herein shall be made by the Commissioner of the General Land Office not less than once each month, when there is land in demand, and at 10 o'clock A. M. on the day fixed therefor. Sales of leases shall be for ten

cents per acre in advance for the first year and twenty-five cents per acre in advance for the second year and fifty cents per acre in advance each year thereafter until production is secured in paying quantities, but not to exceed five years, and a royalty of one-eighth of the gross production of the oil, or the value thereof, produced and saved from the leased premises delivered into such pipe line as the lessee may connect his well, or wells, and one-eighth of the gross production of gas, or the value thereof, produced and sold off the leased premises and in addition thereto such sum, if any, that one may pay therefor as provided herein.

SEC. 3. The commissioner shall advertise the land and the time when the mineral lease will be subject to sale, except as elsewhere provided in the event of tie bids. If there should be no other sufficient means for giving the necessary publicity as to what tracts will be subject to lease and the time when applications may be delivered to the General Land Office, the Commissioner shall have lists of such tracts printed for free distribution at the expense of the State, which expense shall be paid out of the appropriation for public printing. Such lists shall contain a brief designation of the tracts subject to lease and the terms upon which they may be leased and the time when applications therefor will be opened and filed in the General Land Office.

SEC. 4. Separate applications for each tract with one dollar for county clerk recording fee, and the first payment of ten cents per acre and the sum offered in addition thereto, if any, for any tract shall be delivered into the General Land Office on or before the day and hour on which the lease will be subject to sale in sealed envelopes on which shall be endorsed in sub-

stance "Application to Buy Oil and Gas," and in addition thereto the time the lease will be subject to sale. All envelopes so endorsed shall be securely kept by the Commissioner or his chief clerk unopened until the date on which applications are to be opened and at said hour either or both of them shall begin to open the envelopes in the presence of such persons as may desire to be present. All applications received up to the opening hour, whether open or sealed, endorsed or not endorsed, shall be considered as properly delivered into the General Land Office. An application which includes two or more tracts or is for a price less than the fixed royalty and ten cents per acre shall be void. When an application shall have been filed and considered and the land found to be subject to lease, the lease shall be issued for a term not to exceed five years to the applicant that pays the most, if any sum, for the area in addition to the ten cents per acre and the stipulated royalty. If production should not be secured in five years the lease shall terminate and another lease on the land again be subject to sale as in the first instance. A duplicate of the lease shall be kept on file in the General Land Office. All leases shall be forwarded by the Commissioner, with one dollar recording fee, to the proper county clerk, who shall record same and deliver the lease to the lessor or his agent. If two or more persons should offer the same price for the same area and the same should be the highest price offered, all shall be rejected and a date fixed within the discretion of the Commissioner, but not more than fifteen days after rejection, when a lease on the land will be subject to sale as in the first instance; provided no lease shall be sold for a sum less than the

tie bid without the tract having been duly advertised and offered for sale on a regular sale date. All sums paid upon rejected applications shall be returned by the State Treasurer.

SEC. 5. Whenever production is secured in paying quantities and the payment of royalty begins, the owner shall not pay any further annual rental. After production is secured in paying quantities, the owner shall be entitled to an absolute lease which shall run so long as the area produces in paying quantities, subject only to the provisions of this Act. Whenever a lease ceases to produce in paying quantities or the owner fails to pay to the State the royalty due, it shall be subject to forfeiture by the Commissioner, and when sufficiently informed of the facts which authorize a forfeiture he shall forfeit it and the area shall be again offered for sale as in the first instance.

SEC. 6. Royalty of one-eighth of the gross production, as herein provided, shall be paid to the General Land Office for the benefit of the University permanent fund on or before the twentieth day of each month for the preceding month during the life of the lease, and it shall be accompanied by the sworn statement of the owner, manager or other authorized agent showing the gross amount of oil produced and saved since the last report and the amount of gas produced and sold off the premises, and the market value of the oil and gas together with a copy of all daily gauges of tanks, gas meter readings, if any, pipe line receipts, gas line receipts and other checks or memoranda of amount produced and put into pipe lines, tanks or pools and gas lines or gas storage. The books and accounts, the receipts and discharges of all lines, tanks, pools and meters, and all contracts and other

records pertaining to the production, transportation, sale and marketing of the oil and gas shall at all times be subject to inspection and examination by the Commissioner of the General Land Office, the Attorney General, the Governor or member of the Board of Regents of the University of Texas, or the representative of either.

SEC. 7. Royalty and all other sums shall be due and payable to the State at Austin, Texas, and shall be paid to the Commissioner of the General Land Office and he shall transmit all remittances in the form received to the State Treasurer, who shall credit the permanent University fund with all amounts received from royalty. All payments shall be in the form of cash, bank draft on some State or National bank in Texas, or post office or express money order, or such other forms as may be collectible in Austin.

SEC. 8. The State shall have a first lien upon all oil and gas produced upon any leased area to secure the payment of all unpaid royalty and other sum or sums of money that may be due and become due under the provisions of this Act and may follow the same and the value thereof into the hands of any purchaser.

SEC. 9. If oil or gas should be produced in commercial quantities in a well on an adjoining area whether privately owned, or covered by separate lease, which well should be within five hundred feet of an area leased under this Act, the owner of the lease on such University area shall, within sixty days after the initial production on such privately owned area, begin in good faith and prosecute diligently the actual drilling of an offset well or wells on the area so leased from the State and such offset well or wells shall be drilled to such depth and

under such conditions as may be necessary to prevent the undue drainage of oil and gas beneath such University area. A log of such well, whether producer or non-producer, shall be filed in the General Land Office within thirty days after the well has been completed or abandoned.

SEC. 10. One may transfer his lease at any time or a part thereof in any size tract not less than forty acres and such transfer shall be recorded in the county or counties in which the area or part thereof is situated and the recorded transfer or certified copy of same shall be filed in the General Land Office accompanied by one dollar as filing fee and ten cents per acre for each acre in the transfer and thereby the assignee shall have his portion separated from the other part and succeed to all the rights and be subject to all the obligations and penalties of the original lessee. The ten cents per acre as a transfer fee shall be deposited into the State Treasury to the credit of the available University fund, and the lease rental and the bonus paid by a purchaser shall be deposited in the State Treasury to the credit of the University permanent fund.

SEC. 11. An owner may relinquish his lease to the State at any time by having the relinquishment recorded in the county or counties in which the area or part thereof is situated and the recorded relinquishment or certified copy of same shall be filed in the General Land Office accompanied by one dollar as filing fee, and thereby the owner of such lease shall be relieved of any further obligations to the State but such relinquishment shall not have the effect to release the owner from any obligations or liabilities theretofore accrued in favor

of the State. The area so relinquished shall be subject to lease as in the first instance.

SEC. 12. If the owner of a lease should fail or refuse to make the payment of any sum due thereon either as rental or royalty on the production within thirty days after same shall become due, or if such owner or his authorized agent should make any false return, or false report concerning production, royalty or drilling, or if such owner should fail or refuse to drill any offset well or wells in good faith as required by this Act, or if such owner or his agent should refuse the proper authority access to the records or other data pertaining to the operations under this Act, or if such owner or his authorized agent should fail or refuse to give correct information to the proper authority, or fail or refuse to furnish the log of any well as provided herein, such lease shall be subject to forfeiture by the Commissioner of the General Land Office, and when sufficiently informed of the facts which authorized a forfeiture, the Commissioner shall forfeit same, and the area shall be subject to lease again after due advertisement; provided such forfeiture may be set aside and the lease and all rights thereunder reinstated before the rights of another intervene; upon satisfactory evidence of future compliance with the provisions of this Act and the rules and regulations authorized to be adopted for the purpose of executing its provisions.

SEC. 13. Whenever it may be necessary for the owner of a lease to enter the enclosed land of another for the purpose of ingress and egress to and from the area so leased from the State, and such lessee and owner of enclosure or agent of the owner cannot agree upon the terms or place of entry, the lessee or his agent may peti-

tion the Commissioners Court of the county or counties in which such enclosure may be situated in whole or in part for the opening of such way of ingress and egress aforesaid as may be necessary. Upon the filing of such petition it shall be the duty of said court or courts to proceed to lay out and establish in the manner provided for the laying out of third class public roads, such road or roads as may be necessary for the purposes named herein.

SEC. 14. All oil and gas permits heretofore issued upon lands included herein and now in force shall be extended for a term of five years from date thereof and whenever production is secured in paying quantities and the payment of royalty begins, the owner shall not pay any further annual money rental. After production is secured in paying quantities the owner shall be entitled to a lease which shall run so long as the area covered by his lease produces oil or gas in paying quantities, subject to the provisions of this Act.

SEC. 15. The importance of this proposed legislation and the near approach of the close of this session creates an emergency and an imperative public necessity that the rule requiring bills to be read on three separate days in each House be suspended, and that this Act be placed upon its third reading and final passage and take effect from and after its final passage, and it is so enacted.

(NOTE: The enrolled bill shows that the foregoing Act passed the House, 102 yeas, 5 nays; passed the Senate, 27 yeas, 0 nays.)

Approved March 10, 1925.

Effective March 10, 1925.

APPENDIX E

Act of March 31, 1927, 40th Legislature, Page 368
Chapter 249.

WHEREAS, there are now pending in the Supreme Court of Texas two petitions for mandamus against J. T. Robison, Commissioner of the General Land Office in which Geo. W. Theisen and S. Rosa Frank as Relators are seeking to compel the said Commissioner to issue to each an oil and gas permit for the development of those substances under their applications heretofore filed on University land at ten cents per acre and one-eighth royalty under the Act of March 16, 1917, for the alleged reason the Act of March 10, 1925, providing for the sale of oil and gas leases on University land is unconstitutional, and

WHEREAS, the Regents of the University have joined in the attack upon the 1925 Act and if the effort to destroy said Act should be successful and resort have to be had to the Act of 1917 for the development of oil and gas on University land the estimated loss to the University fund amounts to a few million dollars, now, therefore

S. B. No. 474.

An Act to withdraw from sale the oil and gas in University land until such time as the Legislature may enact laws deemed adequate to protect the interest of the University in its available and permanent funds, on the condition only that the University mineral lease or sales Act of March 10, 1925, Chapter 71, Acts of Regular Session, 39th Legislature, shall be held invalid or ineffective by the Supreme Court of Texas in

suits now pending or that may hereafter be filed; and in that event prohibiting the Commissioner of the General Land Office from issuing any oil and gas permit upon any application heretofore or hereafter filed, and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. If, in cases now pending in the Supreme Court or in cases hereafter filed, the said court should decide that the mineral lease or sales Act of March 10, 1925, Chapter 71, Acts Regular Session, 39th Legislature, is invalid or ineffective, then and in that event the minerals in all University land are hereby withdrawn from lease or sale until such time as the Legislature may enact legislation deemed adequate for the protection of the University available and permanent funds; and the Commissioner of the General Land Office shall not, in the event such sales Act is declared unconstitutional, thereafter issue any oil and gas permits on said land upon any application heretofore or hereafter filed, until further legislation as to same.

SEC. 2. The manifest importance of this legislation and the crowded condition of the calendar, creates an emergency and an imperative public necessity exists that the constitutional rule requiring bills to be read on three separate days in each House be suspended and that this be placed upon its third reading and final passage and take effect from and after passage, and it is so enacted.

Approved March 31, 1927.

Effective March 31, 1927.

APPENDIX F

Act of January 11, 1929, 41st Legislature, Page 6.
Chapter 2.

S. B. No. 7.

An Act repealing Chapter 71 of the Acts of the Regular Session of the Thirty-ninth Legislature. Further providing for a withdrawal from lease or sale of all oil and gas in University lands until such time the legislature may enact laws deemed adequate for the protection of the University fund, especially withdrawing from sale or lease oil and gas in University lands advertised for sale for January 2, 1929, as well as for later times during the month of January, and further requiring the Commissioner not to consider any of the applications filed for lease or purchase of such oil and gas so advertised, and further requiring him to forthwith return the applications so filed, together with remittances made therein and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. Chapter seventy-one (71) of the Acts of the Thirty-ninth Legislature is hereby in all things repealed, and all oil and gas in University lands is hereby withdrawn from lease or sale until such time as the legislature may enact laws deemed adequate for the protection of the University funds, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 2. Oil and gas in University lands advertised for sale for January 2, 1929, the date of sale of which was afterwards postponed to January 22, 1929, is specifically withdrawn from sale or lease, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 3. Oil and gas in University lands advertised for sale for January 2, 1929, the sale of which was not postponed, is also specifically withdrawn from sale, or lease, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 4. Oil and gas in University lands advertised for sale for the various days in January, 1929, beginning with January 16th, and other days subsequent thereto in January, is also specifically withdrawn from sale, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 4-a. If any provision or Section of this Act be declared invalid or unconstitutional the same shall not

affect any other portion or provision thereof, and all other provisions shall remain valid and unaffected by any invalid provision, if any.

SEC. 5. The necessity for the immediate protection of the University funds creates an emergency and an imperative public necessity that the rule requiring bills to be read on three several days be suspended, and that this Act shall take effect and be in force from and after its passage, and it is so enacted.

(NOTE—S. B. No. 7 passed the Senate, 27 yeas, 0 nays; passed the House, 119 yeas, 0 nays.)

Approved January 11, 1929.

Effective January 11, 1929.

APPENDIX G

Act of March 29, 1929, 41st Legislature, Page 616.
Chapter 282.

S. B. No. 82.

An Act to provide for the sale of oil and gas in and on University lands; to create a Board to perform the duties with reference thereto provided hereby; to provide for surveying, dividing and marking of said lands; prescribing duties of the Board of Regents of the University of Texas and of the Commissioner of the General Land Office of the State of Texas, authorizing the employment of geologists and mineralogist, and other employees, and making an appropriation, and repealing all laws in conflict herewith, and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. A Board is hereby created to consist of the Commissioner of the General Land Office and two members of the Board of Regents of the University of Texas, neither of whom is employed either directly or indirectly by any oil or gas company, nor is an officer or attorney thereof, to be selected by said Board of Regents, who shall perform the duties hereinafter indicated; the Board shall be known as "Board for Lease of University Lands." The term "Board" wherever it appears hereafter in this Act shall mean "Board for Lease of University Lands." The Board shall keep a complete public record of all its proceedings.

SEC. 2. It is hereby made the duty of the Board to cause to be done such surveying or re-surveying of the blocks and subdivisions thereof of the University lands

as may be necessary to enable the lines of the blocks and sections and fractional sections to be determined and identified and have such corners as may be necessary to that end permanently marked. When it is impracticable to establish such lines and corners as originally surveyed, or when such sections have not been actually surveyed on the ground, the blocks shall be surveyed or re-surveyed and divided into surveys of sections and fractional sections and as many corners thereof as may be necessary for the identification shall be permanently marked. The surveyors employed to do such surveying shall be approved by said Board. The field notes of such surveys shall be returned to the General Land Office, and when correct and in accordance with law, shall be approved by the Commissioner, filed in the General Land Office and become archives therein.

SEC. 3. The oil and gas in the University land shall be subject to sale on and after June 1, 1929, under the regulations, at the times and on the terms provided herein, together with such rules and regulations as may be authorized herein to be adopted by the Board, but not inconsistent with the provisions of this Act.

SEC. 4. Whenever there shall be such demand for the purchase of the oil and gas in any one or more separate whole surveys of sections or fractional sections of University land as will reasonably insure that said oil and gas may be sold advantageously, the Board shall place said oil and gas in said lands on the market in separate whole surveys only or in subdivisions of said surveys. It shall cause to be advertised a brief description of the lands from which the oil and gas is proposed to be sold and that sealed bids for the purchase of said oil and gas by lease will be opened at a designated day,

at ten o'clock A. M. on that day, and that sealed bids received up to that time will be considered. Said advertisement shall be made:

(*a*) By insertion in two or more papers of general circulation in this State.

(*b*) By mailing a copy thereof to the County Clerk and County Judge of every county in this State.

(*c*) In addition to the two foregoing mandatory provisions, the Board may in its discretion, cause said advertisement to be placed in oil and gas journals in and out of the State and to be mailed generally to such persons as they think might be interested.

SEC. 5. All bids shall be directed to the said Board in care of the General Land Office of the State of Texas, and shall be retained by the Commissioner of the General Land Office until the day designated for the opening of bids and upon that day the said Board, or a majority of its members shall open said bids and shall list and file and register all bids and money received. A separate bid shall be made for each whole survey or subdivision thereof. No bid shall be accepted which offers a royalty of less than one-eighth of the gross production of oil and gas in the land bid upon, and this minimum royalty may be increased at the discretion of the Board, all members concurring, before the promulgation of the advertisement of the land. Every bid shall carry the obligation to pay an amount not less than ten cents per acre for delay in drilling, such amount to be fixed by the Board in advance of the advertisement, and which shall be paid every year for five years, unless in the meantime production in paying quantities is had upon the land.

SEC. 6. Every bid shall be accompanied by a payment

equal to the minimum price fixed on the land per acre for delay in drilling of the land bid for, which amount will constitute the first year rental payment for delay in drilling if the bid is accepted. The bid shall further indicate the royalty the bidder is willing to pay, which royalty shall not be less than one-eighth of the gross production. The bid shall further name such amount as the bidder may be willing to pay in addition to the royalty and the annual payment herein provided for, and shall be accompanied by cash or checks collectible in Austin to cover said amounts.

SEC. 7. If any one of the bidders shall have offered a reasonable and proper price therefor, not less than the price fixed by the Board, the lands advertised, or any whole survey or subdivision thereof, may be leased for oil and gas purposes under the terms of this Act and such regulations as the Board may prescribe, not inconsistent with the provisions of this Act. If after any bidding by sealed bids the Board should reject all bids, as it is hereby authorized to do, it may thereafter offer for sale and sell the oil and gas in said lands, in separate whole surveys only or subdivisions thereof, by open public auction to be held at a time and place designated by the Board and after adequate and proper notice, but no disposition shall be made of said oil and gas in said lands at such public auction at a price less than the price offered by the sealed bids. All bids may be rejected. In the event of no sale at public auction, any subsequent procedure for the sale of said oil and gas leases shall be in the manner above provided.

SEC. 8. If the Board shall determine that a satisfactory bid has been received for said oil and gas, it

shall make an award to the applicant, offering the highest price therefor, and a lease shall be executed by the Commissioner of the General Land Office, a duplicate copy of such lease shall be filed in the General Land Office. Whenever the royalties shall amount to as much as the yearly payment as fixed by the Board, the yearly payment may be discontinued. If before the expiration of three years oil and gas in paying quantities shall not have been produced, the lease shall terminate. The lease shall include such additional provisions and regulations as the Board may prescribe to preserve the interest of the State and safeguard the interests of the University funds, but not inconsistent with the provisions of this Act.

SEC. 9. If during the term of any lease issued under the provisions of this Act the lessee shall be engaged in actual drilling operations for the discovery of oil and gas on land covered by any such lease, no rentals shall be payable as to the tract on which such operations are being conducted so long as such operations are proceeding in good faith; and in the event oil or gas is discovered in paying quantities on any tract covered by any such lease, then the lease as to such tract shall remain in force so long as oil or gas is produced in paying quantities from such tract. In the event of the discovery of oil or gas on any tract covered by a lease issued hereunder or on any land adjoining same, the lessee shall conduct such operations as may be necessary to prevent drainage from the tract covered by such lease and to properly develop the same. Failure to comply with the obligations provided by this section shall subject the holder of the lease to the penalties provided in Section 12 and 13 of this Act.

SEC. 10. Title to all rights purchased may be held by the owners so long as the area produces oil and gas in paying quantities. All rights purchased may be assigned in quantities of not less than forty acres; unless there be less than forty acres remaining in any survey, in which case such lesser area may be so assigned. All assignments shall be filed in the General Land Office within one hundred days after the date of the first acknowledgment thereof, accompanied by ten cents per acre for each acre assigned, and if not so filed and payment made, the assignment shall be ineffective. All rights to any whole survey and to any assigned portion thereof may be relinquished to the State at any time by having an instrument of relinquishment recorded in the county or counties, in which the area may be situated and filed in the Land Office accompanied with one dollar for each area assigned, but such assignment shall not relieve the owner of any past due obligations theretofore accrued thereon. The Board shall authorize the laying of pipe lines, telephone lines and the opening of such roads over the University lands as may be deemed reasonably necessary for and incident to the purposes of this Act.

SEC. 11. Royalty as stipulated in the sale shall be paid to the General Land Office at Austin, Texas, for the benefit of the University Permanent Fund on or before the 20th day of each succeeding month for the preceding month during the life of the rights purchased and it shall be accompanied by the sworn statement of the owner, manager or other authorized agent showing the gross amount of oil produced and saved since the last report and the amount of gas produced and sold off the premises and the market value of the oil and

gas, together with a copy of all daily gauges of tanks, gas meter readings, pipe line receipts, gas line receipts, and other checks and memoranda of the amounts produced and put into pipe lines, tanks or pools and gas lines or gas storage. The books and accounts, receipt and discharges of all wells, tanks, pools, meters, pipe lines and all contracts and other records pertaining to the production, transportation, sale and marketing of the oil and gas shall at all times be subject to inspection and examination by the Commissioner of the General Land Office, the Attorney General, the Governor, or any member of the Board of Regents of the University of Texas, or the representative of either.

SEC. 12. In every case where the area in which the oil and gas sold shall be contiguous or adjacent to land not University land, the acceptance of the bid and the sale made thereby shall constitute an obligation on the owner thereof to adequately protect the land leased from drainage from adjacent lands. In cases where the area in which the oil and gas is sold is contiguous to other University lands leased or sold, at a lesser royalty, the owner shall likewise protect the State from drainage from the land so leased or sold for a lesser royalty. Upon failure to protect the land from drainage as herein provided the sale and all rights thereunder may be forfeited by the Board in the manner elsewhere provided herein for forfeitures.

SEC. 13. If the owner of the rights acquired under this Act shall fail or refuse to make the payment of any sum due thereon, either as rental or royalty on the production within thirty days after same shall become due, or if such owner or his authorized agent should make any false return or false report concerning pro-

duction, royalty or drilling, or if such owner shall fail or refuse to drill any offset well or wells in good faith, as required by his lease, or if such owner or his agent should refuse the proper authority to access to the records and other data pertaining to the operations under this Act, or if such owner, or his authorized agent, should fail or refuse to give correct information to the proper authorities, or fail or refuse to furnish the log of any well within thirty days after production is found in paying quantities, or if any of the material terms of the lease should be violated, such lease shall be subject to forfeiture by the Board by an order entered upon the minutes of the Board reciting the facts constituting the default, and declaring the forfeiture. The Board may, if it so determines, have suit instituted for forfeiture through the Attorney General of the State. Upon proper showing by the forfeiting owner, within thirty days after the declaration of forfeiture, the lease may, at the discretion of the Board and upon such terms as it may prescribe, be reinstated. In case of violation by the owner of the lease contract, the remedy of the State by forfeiture shall not be the exclusive remedy, but suit for damages or specific performance, or both, may be instituted. The State shall have a first lien upon all oil and gas produced upon the leased area and upon all rigs, tanks, pipe line, telephone lines and machinery and appliances used in the production and handling of oil and gas produced thereon, to secure any amount due from the owner of said lease.

SEC. 14. All surveys, files, records, copies of sale and lease contracts, and all other records pertaining to the sales and leases hereby authorized shall be filed in the General Land Office and constitute archives thereof.

Payment hereunder shall be made to the Commissioner of the General Land Office at Austin, Texas, who shall transmit to the State Treasurer all royalty for deposit to the credit of the Permanent University Fund and all rentals for delay in drilling and all other payments, including all filing assignments and reinquishment fees hereunder to the credit of the Available University Fund.

SEC. 15. The Board is authorized to employ a geologist and a mineralogist who shall keep informed with reference to the minerals in University lands and all activities under this and previous leases and sales and shall report to the Board all information gained with reference thereto. The Board is also authorized to employ other necessary employees. The salaries of such employees shall be paid monthly, and no salary shall be paid in excess of six thousand ($6,000) dollars per annum.

SEC. 16. The expenses of executing the provisions of this Act shall be paid monthly by warrants drawn by the Comptroller on the State Treasurer, and for that purpose the sum of twenty thousand ($20,000) dollars or as much thereof as may be necessary is hereby appropriated out of any money in the Treasury not otherwise appropriated until September 1, 1929.

SEC. 17. If any provision hereof should be held unconstitutional, the balance of the Act shall not be affected thereby.

SEC. 18. The Board shall adopt proper forms and regulations rules and contract as will in its best judgment protect the income from lands leased hereunder. A majority of the Board shall have power to act in all cases, except where otherwise herein pro-

vided. The Board may reject any and all bids, and shall have the further right to withdraw any lands advertised for lease prior to receiving and opening bids. Any and all or parts of laws in conflict with this Act are hereby repealed.

SEC. 19. Since there is no law authorizing the sale of oil and gas leases on University lands this fact creates an emergency and an imperative public necessity exists that the constitutional rule requiring bills to be read on three separate days in each House be suspended and that this be placed upon third reading and final passage and take effect from and after passage, and it is so enacted.

(NOTE—S. B. No. 82 passed the Senate, 25 ayes, 0 nays; Senate adopted free conference report, 28 ayes, 0 nays; passed House with amendments, 104 ayes, 23 nays; House adopted free conference report, 103 ayes, 5 nays.)

Approved March 29, 1929.

Effective March 29, 1929.

APPENDIX H

House Bill No. 812 of 1913.

A Bill
To Be Entitled

An Act to Amend Article 7504, *Revised Civil Statutes of* 1911, *by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land, authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.*

Be It Enacted By the Legislature of the State of Texas:

SECTION 1. That Article 7504, Revised Civil Statutes of the State of Texas, be amended so as to hereafter read as follows:

ART. 7504. Real property for the purpose of taxation shall be construed to include the land itself, whether laid out in town lots or otherwise, and all the buildings, structures and improvements, and other fixtures of whatsoever kind thereon, and all the rights and privileges belonging or in any wise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same, also all lease-hold interests whereby the lessee, grantee or licensee is authorized to mine and prospect for and take from lands, stone, granite, marble, fossils, minerals of any kind, including oil and gas.

SEC. 2. The fact that the right of the State to tax leasehold interests in lands under which the lessee, grantee or licensee is permitted to prospect for and mine or take from said lands minerals, including oil and gas, is being disputed by the owners of said lease-hold interests, and the State is being forced to have litigation with such persons, there-

fore the necessity to render the law of this State upon said subject beyond cavil or the possibility of a doubt, creates an emergency and an imperative public necessity requiring that the constitutional rule requiring bills to be read on three several days in both Houses be suspended, and it is accordingly so done, and that this Act be in force and take effect from and after its passage, and it is so enacted.

Floor Report.

Committee Room, Austin, Texas.

March 19, 1913.

Hon. Chester H. Terrell, Speaker of the House of Representatives:

Sir: Your Committee on Revenue and Taxation, to whom was referred House Bill No. 812, a bill to be entitled

An Act to Amend Article 7504, *Revised Civil Statutes of* 1911, *by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land, authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency,*

Have had the same under consideration, and I am instructed to report it back to the House with the recommendation that it do pass.

MANGUM, *Chairman*,
KIRBY,
SPRADLEY,
BURGES,
(For the purpose of getting before the House only).

ROACH,
LANE,
DOVE,
KENNEDY,
PATTON,
DAVIS,
KING,
POWELL,
DIFFIE.

House Bill 812.

By KENNEDY

A Bill
To Be Entitled

An Act to Amend Article 7504, Revised Civil Statutes of 1911, by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.

March 8, 1913, Read first time and referred to Committee on Revenue and Taxation.

TERREL.

Favorable Floor Report
3-19-13

ROACH.

THE STATE OF TEXAS
DEPARTMENT OF STATE

I, Jane Y. McCallum, Secretary of State, of the State of Texas, do hereby certify that the foregoing is a true and correct copy of

HOUSE BILL No. 812

introduced at the 33rd Legislature; and the report attached thereto with the endorsement thereon, as now appears of record in this Department.

In Testimony Whereof, I have hereunto signed my name officially and caused to be impressed hereon the Seal of State at my office in the City of Austin, this 10th day of April, A. D. 1930.

(SEAL) JANE Y. MCCALLUM,
Secretary of State.

FILE COPY

No. 425

FILED
JAN 26 1931
CHARLES ELMORE CROPLEY,
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner,*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONER

—BY—

HOMER L. BRUCE,
JAS. A. BAKER,
Solicitors for Petitioner.

Of Counsel:
BAKER, BOTTS, ANDREWS & WHARTON.
Houston, Texas.

McCURDY-YOUNG CO., HOUSTON

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No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONER

Opinions Below.

The opinion of the United States District Court for the Western District of Texas (R. 27) is reported in 38 Fed (2nd) 680. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 47) is reported in 41 Fed. (2nd) 483.

The references herein to the Record are to the pages of the re-printed record and not of the original.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on June 18, 1930. (R. 49.) Motion for rehear-

ing was filed on July 7, 1930 (R. 50), which was considered and denied on August 1, 1930. (R. 50.) Petition for writ of certiorari was filed September 6, 1930. The writ was at first denied on October 20, 1930, but, on a petition for rehearing, was granted on November 24, 1930. (R. 51.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Brief Statement of Question Involved.

Petitioner is the holder of oil and gas leases granted by the State of Texas on part of that State's public domain, and brought this suit to recover Federal income taxes it had paid on income derived solely from its operation of its State leases. This Court in a series of cases arising from Oklahoma has held that the holders of oil and gas leases, granted by the United States upon Indian lands, are agencies and instrumentalities of the United States government, and the State of Oklahoma may not levy any taxes, including an income tax, upon such lessees. Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292; Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522; Howard v. Gipsy Oil Company, 247 U. S. 503; Large Oil Company v. Howard, 248 U. S. 549 (reversing the decision of the Supreme Court of Oklahoma in Large Oil Company v. Howard, 63 Okla. 143); Gillespie v. Oklahoma, 257 U. S. 501; and Jaybird Mining Company v. Weir, 271 U. S. 609. In the Gillespie case this Court held invalid an income tax levied by Oklahoma upon the net income of such a Federal lessee. This Court in The Collector v. Day, 78 U. S. (11 Wall.), 113, 127; United States v. Railroad

Company, 84 U. S. (17 Wall.) 322, 327-8; Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584; and in Ambrosini v. United States, 187 U. S. 1, 7, and many other cases, has held that instrumentalities of the States are exempt from Federal taxation to the same extent and for the same reasons that similar Federal instrumentalities are exempt from State taxation.

The United States District Court for the Western District of Texas held petitioner's income was exempt, and rendered judgment in its favor for $736,796.25, the amount of the taxes sued for. The Circuit Court of Appeals reversed the judgment on the ground that by Section 27 of the act under which petitioner's leases were granted, which provided that "rights acquired under this Act shall be subject to taxation as is other property," the State had waived this exemption.

Petitioner contends that its income from its State leases is exempt from these income taxes under the Federal Constitution and the treaty between the United States and the Republic of Texas under which the latter became the State of Texas, and that Section 27 referred only to State taxation and the State did not thereby waive its fundamental right to have its instrumentalities free from control on the part of the Federal government through taxation or otherwise.

The State of Texas, through its brief as *amicus curiae* in connection with the petition for a rehearing of the application for a writ of certiorari, has in this case taken the same position as the petitioner, and is now itself denying the right of the Federal government to levy these taxes upon petitioner and other similar lessees of the State.

Statutes Involved.

The relevant portions of the constitutional and statutory provisions will be found in the Appendix, *infra*, pages 76 to 127.

Statement.

Petitioner filed its original petition (R. 1) to recover income taxes it had paid under the Revenue Acts of 1924, 1926 and 1928, to respondent for the periods from July 1, 1924, to March 31, 1928, which had been assessed on account of income derived by petitioner from its operation of oil and gas leases granted by the State of Texas on part of that State's public lands. Petitioner asserted its said income was exempt from these Federal income taxes on the following grounds:

The lands covered by the leases have always been a part of the public domain of the State of Texas, and its predecessor governments, the Kingdom of Spain, the Republic of Mexico, the Republic of Texas, and finally the State of Texas. The United States, in the compact between the Republic of Texas and the United States under which the Republic of Texas became the State of Texas (as shown in 5 Stats. 797; 9 Stats. 108; Gammel's Laws of Texas, Vol. 2, pp. 1200, 1225 and 1228), expressly guaranteed that the State of Texas should retain its vacant and unappropriated lands, which included the specific tracts covered by petitioner's leases, and dispose of them as said State might direct. The lands involved have been set aside by the State for the support of the University of Texas, a university established and maintained by the State of Texas. In order for the State to secure the development of its oil and gas and other minerals and convert them into

money for the benefit of the State and its university, the State granted oil and gas leases upon these lands, reserving a royalty equal to one-eighth of the oil and one-tenth of the gas. Petitioner held two such leases (copies of which are set forth at R. 13 and 17). The income taxes paid were assessed on income derived by petitioner solely from the sale of oil and gas produced by it from these State leases and from its operation thereof. Petitioner had other taxable income, but this was more than offset by properly deductible expenses, and none of the taxes paid were assessed because of this outside taxable income. Its claims to exemption may be summarized as follows:

1. The taxes are a burden on the power and right of the State of Texas to develop its own oil and gas resources, and could be used by the Federal Government to destroy that power and right.

2. The taxes are a burden upon the leases and the petitioner as the owner thereof, chosen by the State as means to develop its mineral resources, and could be used to render them impotent as such means and agencies.

3. The taxes are upon the rights and franchises granted by the State.

4. The leases are exempt from Federal taxation, and petitioner's income therefrom is likewise exempt.

5. The taxes prevent the petitioner from producing the maximum amount of oil, and thus reduce the State's returns through its royalties.

6. If these taxes could be levied by the Federal Government on the State's lessees, this would have a sensible influence on the terms the State could require in the leases and the amount of royalties it could reserve.

It alleged the taxes were invalid on each of the foregoing grounds, both under the Constitution of the United States and under the express guarantee of the United States in its compact with the Republic of Texas that the new State of Texas should retain its public lands as its own and dispose of them as it deemed best.

All necessary prerequisites under the revenue laws as to filing claims for refund and their rejection before the suit was filed were alleged, and were admitted by respondent.

The respondent filed a formal answer (R. 20), and an agreed Statement of Facts (R. 21) was filed, which admitted all the allegations of petitioner except those alleging the legal propositions on which petitioner based its claim to exemption. The effect was to narrow the issues to the one question of whether the petitioner was under the facts alleged exempt from the Federal income taxes. We quote the following from the Agreed Statement of Facts:

> "It is the desire of both plaintiff and defendant to eliminate in this cause every issue affecting plaintiff's Federal income taxes for the years involved, except the single question of exemption asserted by plaintiff." (R. 23.)
>
> "The income taxes sued for by plaintiff were assessed against, and paid by, it on its said income derived from the sale of said oil and gas. If plaintiff is entitled to recover any part of the taxes sued for, it is entitled to recover all of them." (R. 23.)

The case was tried before the court on written waiver of a jury. (R. 21.) On February 19, 1930, the court filed its opinion (R. 27), sustaining petitioner's con-

tentions in full, and on February 28, 1930, entered judgment in petitioner's favor for the taxes sued for. (R. 37.)

The Circuit Court of Appeals on June 18, 1930, rendered its opinion (R. 47) and entered its order and judgment (R. 49), reversing the judgment of the District Court. After a motion for rehearing, filed on July 7, 1930 (R. 50), was considered and overruled on August 1, 1930 (R. 50), petitioner filed in this court its application for writ of certiorari on September 6, 1930, and the writ was granted on November 24, 1930. (R. 51.)

Specification of Errors To Be Urged.

The assigned errors intended to be urged are fully set forth in the petition for writ of certiorari, and may be summarized as follows:

1. The Circuit Court of Appeals erred in reversing the judgment of the District Court because on the authority of the decision in Gillespie v. Oklahoma, 257 U. S. 501, and the other decisions of this court referred to, petitioner is exempt from the Federal income tax as an instrumentality of the State of Texas.

2. The said court erred in reversing the judgment of the District Court because the taxes involved are a burden upon, impair, and are in derogation of, said State's right, under the Constitution of the United States and the treaty between the United States and the Republic of Texas, to develop its own mineral resources free from interference by the United States, and are an unauthorized burden upon petitioner and its leases, the agencies chosen by the State for the purpose of exercising this right.

3. The said court erred in holding that by Section 27 of the 1917 Leasing Act the State of Texas granted its permission to the United States to levy these taxes upon its instrumentality, the petitioner, because said section dealt solely with taxation by said State and its subdivisions, and not with taxes levied by the United States.

4. The said court erred in holding the collection of said taxes was allowed under said Section 27 because said section was repealed on March 10, 1925, before any of said taxes were levied or became due.

5. The court erred in holding, if in fact it did hold, that under the decision of the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489, petitioner was not an instrumentality of the State, but was merely a purchaser of the minerals, because neither petitioner's leases nor said decision of the Supreme Court of Texas sustain such a holding.

Summary of Argument.

The exemption of State instrumentalities from Federal taxation, and vice versa, has been read into the Constitution for the protection of the State and Federal governments from encroachments by the one upon the exercise by the other of its sovereign and independent powers. Each government within the sphere of its own reserved or granted powers is supreme. Taxation of the agencies of the one by the other is an interference with that government's exercise of its sovereign functions which it is performing through the designated agency. The individual welfare of the instrumentality, considered as separate and apart from its governmental connection, was not the reason for

the origin of the rule. Therefore, in this case, petitioner is not before this court simply as an individual taxpayer. It is here in its representative capacity as an agency of the State of Texas. Through it the State of Texas is asserting the fundamental proposition that the State has the right to develop its own oil and gas resources under its public domain free from control or hindrance on the part of the Federal government.

The State and its predecessor governments have always owned the lands involved as part of their public domain. In the compact between the United States and the Republic of Texas the former expressly guaranteed that the new State of Texas should retain its public lands as its own. The United States may levy no tax upon the State's lands or interfere in any way with its enjoyment of all its rights as the owner thereof. Van Brocklin v. Tennessee, 117 U. S. 151. As a part of the land the State owns the oil and gas thereunder, and one of its rights as such owner is the right to produce, or have produced for it, this oil and gas. Gillespie v. Oklahoma, 257 U. S. 501. The Federal government may not burden or impede the State in the exercise of its sovereign right to realize upon its own oil and gas resources.

The State may in its unrestricted discretion choose between itself producing the minerals, or having them developed in the usual and customary method through leases. It has chosen the latter method, and this petitioner and other similar lessees are appropriate instrumentalities through which the State exercises this right. The State has granted these leases, not for the private use and profit of the lessee, as in the case of grants to homesteaders where the State retains no connection

with the land, but for the purpose of securing the development of the State's own minerals, and it remains vitally connected with the leases at all times. These lessees fall within that class of instrumentalities that are exempt from taxation by the Federal government. An income tax upon their net income from the leases burdens and impedes the State in developing its minerals and is therefore invalid. Gillespie v. Oklahoma, *supra*.

It is immaterial for what purpose the State uses the revenue derived from its minerals. The tax, if it attaches at all, attaches at the time the minerals are produced and converted into money and before the State makes any use of their proceeds. However, the maintenance of the University of Texas, for which these lands have been set aside, is a governmental activity.

Section 27 of the 1917 Leasing Act, under which petitioner's leases were issued, that "rights acquired under this Act shall be subject to taxation as is other property" referred solely to taxation by the State and its subdivisions, and did not embrace Federal taxes. It was inserted to assure the taxability of these leases if litigation then pending in the State courts should result in oil and gas leases being held not to constitute property subject to taxation as such property was then defined in the general taxing statutes. If Section 27 is construed to include Federal taxes, the State has then waived its sovereign right to have its agencies exempt from Federal control through taxation. As this is a waiver of its sovereign rights, this section must be construed strictly in the State's favor, and when so construed, it clearly is not a waiver by the State of

these rights. Furthermore, it is submitted that Section 27 was repealed on March 10, 1925, before any of the taxes involved herein accrued.

Argument.

I.

The State of Texas may not be hindered or impeded in any manner by the United States in developing its own oil and gas resources on its public domain.

The lands embraced in petitioner's leases have always been a part of the public domain of the State and its predecessor governments, the Republic of Texas, the Republic of Mexico and the Kingdom of Spain. The Republic of Texas became one of the United States after extended negotiations between the two republics which resulted in a compact between the two nations, evidenced by resolutions of the United States Congress and of the Congress and of the Convention of the Republic of Texas, 5 Stat. 797; 9 Stat. 108; Gammel's Laws of Texas, Vol. 2, pp. 1200, 1225 and 1228. These resolutions are set forth at page 76 of the Appendix to this brief. Texas had a small population and by far the greater part of its territory was still owned by the Republic as the sovereign of the soil, while at the same time its debts and liabilities were large. The disposition of its public lands and liabilities was the subject of extended negotiations. It was proposed that (a) the United States should assume Texas' debts and in return take over its public lands, or (b) Texas would retain both its lands and its liabilities. The latter alternative was finally agreed upon, and the ultimate compact, therefore, included the following spe-

cific guarantee in the resolution of the Congress consenting to the admission of Texas:

> "2. And be it further resolved, that the foregoing consent of Congress is given upon the following conditions, and with the following guarantees, to wit: * * *
>
> "*Second.* Said State * * * *shall also retain all the vacant and unappropriated lands lying within its limits,* to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after discharging said debt and liabilities, *to be disposed of as said State may direct;* but in no event are said debts and liabilities to become a charge upon the Government of the United States."

Thus the State of Texas and the United States have the same relation to their respective public lands. Each holds title as the original sovereign of the soil, and neither may interfere with the other's enjoyment and exercise of all of its rights as such owner. Each government has the sovereign right to retain, own, cultivate and utilize its lands and enjoy all the rights and privileges of ownership in them without interference or hindrance from the other, whether by taxation or otherwise. If one may tax the other's lands or control their use, then that government's ownership is not independent and sovereign but dependent and subject to the will of the other.

The complete independence of each government in regard to its public domain has been illustrated in numerous decisions of this Court. This whole subject was exhaustively reviewed in Van Brocklin v. Tennessee, 117 U. S. 151, in which this Court held that no State may levy any tax upon property of the United States. In that case this Court stated that:

> "Whether the property of the United States shall be taxed under the laws of a State depends upon the will of its owner, the United States, and no State can tax the property of the United States without their consent."

A State may not collect from a subsequent owner taxes for the year during which the land belonged to the United States; Wisconsin Central Railroad Company v. Price, 133 U. S. 496; Irwin v. Wright, 258 U. S. 219, 228; Lee v. Osceola & Little River Road Improvement District, 268 U. S. 643; or tax the property of a corporation owned and controlled by the United States, Clallam County v. United States, 263 U. S. 341. Whether title has passed from the United States depends upon the national and not the State laws. Wilcox v. Jackson, 13 Peters 498, 516-7; Gibson v. Chouteau, 13 Wall. (80 U. S.) 92, 99. Its title may not be divested by possession under State statutes of limitations. Jourdan v. Barrett, 4 Howard (45 U. S.) 169, 185. The United States and the separate States hold their lands in trust for the people for public purposes, but have all the rights of any owner in them. United States v. Insley, 130 U. S. 263, 265; Light v. United States, 220 U. S. 523, 536. The government "has, with respect to its own lands, the rights of an ordinary proprietor, to maintain its possession and to prosecute trespassers. It may deal with such lands precisely as a private individual may deal with his farming property. It may sell or withhold them from sale." Camfield v. United States, 167 U. S. 518; United States v. Midwest Oil Company, 236 U. S. 459, 474. The United States may reserve from sale for an indefinite period all its lands in a State and thus deprive the State of revenue

derived from their taxation, but the possibility of such conduct on the part of Congress "is no reason for a misconstruction of the scope and extent of that power." Stearns v. Minnesota, 179 U. S. 223, 243.

The same considerations establish the absolute independence of the State of Texas in regard to its public domain. A different rule would place it completely at the mercy of Federal legislation. Utah Power & Light Company v. United States, 243 U. S. 389, 405.

The oil and gas under the ground are as much a part of the public domain as the surface, and the State's right to produce them, or have them produced, is only one of the rights constituting its composite ownership. Since the United States may not interfere with its enjoyment of its rights as owner of these lands, it may not impede the State in bringing them to the surface.

This Court has specifically held that the production of oil and gas is one of the incidental rights of ownership. The United States holds certain Indian lands in Oklahoma for the benefit of the Indians, and this Court has consistently held that, since the State of Oklahoma may not tax the lands themselves, it may not through taxation or otherwise control or impede the United States in having the minerals produced for the benefit of the Indians. Choctaw, Oklahoma & Gulf Railroad Co. v. Harrison, 235 U. S. 292; Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522; Howard v. Gipsy Oil Co., 247 U. S. 503; Large Oil Co. v. Howard, 248 U. S. 549 (reversing 63 Okla. 143); Gillespie v. Oklahoma, 257 U. S. 501; Jaybird Mining Co. v. Weir, 271 U. S. 609.

If the State should establish a separate governmental department and through it directly drill wells upon its

lands and produce the oil and gas, the United States could in no way interfere with the State in this activity. The State could not be required to pay a Federal income tax upon its income or any other tax to the Federal government. Its employes would likewise be exempt.

If the United States may interfere, by taxation or otherwise, with the State's production of its own minerals, then it would necessarily follow that the State could produce them only on such terms as the United States might impose. It would further follow that the United States might, if it chose, levy an income tax upon the income of the State of Texas from its own oil and gas, for, as this Court said in United States v. Railroad Company, 17 Wall. (84 U. S.) 322, 332, in denying the right of the Federal government to require a railroad to deduct a tax of five per cent upon the interest paid the City of Baltimore on bonds of the company owned by the city:

> "We admit the proposition of the counsel, that the revenue must be municipal in its nature to entitle it to the exemption claimed."

Yet this court held the interest paid the city was exempt and municipal in nature as the city had subscribed for the bonds because it "with a view to its commercial prosperity, was desirous of aiding in the construction of a railroad," that would bring trade to the city. If such an activity is municipal in nature, the development by the State of its own sovereign public domain is a sovereign activity, and any attempt by the United States to interfere therewith would be in derogation of the State's sovereign prerogatives.

This freedom of the State from Federal control arises

not only under the United States Constitution but under the express guarantee of the United States in its agreement with the Republic of Texas that the State of Texas "shall also retain all the vacant and unappropriated lands lying within its limits * * * to be disposed of as said State may direct." This guarantee was a part of a compact between the two independent nations. They were negotiating with perfect freedom of action upon the part of both parties, and they could have established a mere understanding for mutual defense, a confederation or any kind of association. They finally agreed that the Republic of Texas should become one of the States under certain specific guarantees, and those conditions are now as binding obligations upon the United States as any other treaty.

Cases like South Carolina v. United States, 199 U. S. 437, are entirely different in every respect. The Constitution allowed the Federal government to levy excise taxes, and it had been collecting such taxes in the form of licenses from all dispensers of liquor. South Carolina took over the entire business of selling liquor in that State, and the question involved was whether the dispensers employed by the State were subject to the Federal license tax, and this Court held they were. The real ground of the decision was the thought or fear that the States, "mingling the thought of profit with the necessity of regulation," might take over the exclusive operation of all kinds of business formerly carried on by private individuals, and thus dry up the sources of Federal taxation. Concerning that case this Court said in Murray v. Wilson Distilling Co., 213 U. S. 151, 173:

"That case was concerned with the power of a

> State, by virtue of its legislation in regard to the sale and consumption of liquor, to destroy a pre-existing right of taxation possessed by the government of the United States."

The State of Texas in having its oil and gas produced has not gone into the oil business. It has not, as a result of "mingling the thought of profit with the necessity of regulation" taken over the operation of the oil business. It has created no State monopoly. It has not purchased these lands with the view of deriving a profit from the production of oil to pay its operating expenses. It is simply producing the oil from lands that were claimed for the Kingdom of Spain by its original discoverers and settlers, and its title thereto is independent and absolute. Shively v. Bowlby, 152 U. S. 1, 50. The first act of an explorer is to claim the new land for his sovereign.

This distinction is clearly pointed out by the recent decision in Sherman et al. v. The United States of America (No. 14, October Term, 1930, decided November 24, 1930), in which this Court held that the California Board of State Harbor Commissioners in operating the State Belt Railroad was not subject to the Federal Safety Appliance Acts. In that case this Court said:

> "California has not gone into the business generally as a common carrier, but simply has constructed the Belt Line as an incident of its control of the harbor—a State prerogative."

In the same way Texas has not gone into the oil business generally, but simply is producing its own oil and gas as an incident of its ownership of its public domain, one of the strongest prerogatives of the State.

No pre-existing source of Federal revenue is affected,

as in the South Carolina case. The United States may levy no taxes on these lands. No one may drill them or produce oil or gas therefrom without the State's consent. Therefore there can be no income from the minerals, whether subject to Federal income taxes or not, until the State acts. Hence it follows a denial of the right of the United States to levy an income tax upon the State or any of its agencies will not destroy any pre-existing right of taxation possessed by the United States.

Nor does this case involve the question of whether other activities of the State, like the examples in the South Carolina case, would be exempt. This case deals solely with the rights of the State in lands it still holds by virtue of its original ownership as sovereign of the soil and not in lands it has purchased for private gain.

It therefore is clear that the United States may not interfere with the State of Texas in its production of this oil and gas, whether through taxation or otherwise.

It is immaterial for what purpose the State uses the proceeds of the oil or gas. United States bonds are exempt from all State taxation, whether by way of ad-valorem taxes on the bonds or income taxes on the interest, regardless of how the holder may use or invest the interest or principal thereof when paid to him. If he invests it in ordinary private property, that property becomes liable for State taxes, but the exemption of the bonds themselves and the interest is not affected thereby. In the same way the State has the right to produce its oil free from Federal control regardless of the purpose for which it may subsequently use its revenues therefrom.

However the State is using its income from these lands for carrying out its public functions as a government. The Texas Constitution of 1776, by Article VII, Sections 10 to 15 (set out at page 84 of the Appendix), commanded the legislature to establish and provide for the maintenance of a university of the first class, styled "The University of Texas," and by Section 15 set aside an additional 1,000,000 acres of the public domain for its endowment, support and maintenance. The leases involved are upon a part of these lands. Thereupon the legislature by the Act of March 30, 1881 (Laws of 1881, Ch. 75, p. 79), created the present University of Texas. It is strictly a State school, supported and maintained by appropriations by the legislature, and governed by a board of regents appointed by the Governor. The present articles of the Revised Statutes of 1925 dealing with its management and control are Articles 2584 to 2606 and 2907, but their details are immaterial.

The University of Texas is not a separate private corporation but is a mere branch of the State government. Phillips v. Virginia University, 97 Va. 472; Hjorth Royalty Co. v. Trustees of University of Wyoming, 30 Wyo. 309. The State continues to own these lands as fully as before they were set aside for the university. Smisson v. State, 71 Tex. 222, 231; Theisen v. Robison, 117 Tex. 489, 503. In York v. Alley, 25 S. W. (2nd) 193, 195 (writ of error refused by Supreme Court of Texas), the court said concerning the university's lands:

> "But in either event it belongs to the State of Texas, whose title is not that of a mere trustee. The State owns the land just as fully as before it was dedicated to public educational purposes.

Theisen v. Robison, 117 Tex. 489, 8 S. W. (2nd) 646; Smisson v. State, 71 Tex. 222, 9 S. W. 112; Greene v. Robison, 109 Tex. 367, 210 S. W. 498."

The maintenance of public schools for the education of the youth and training of future citizens is, and has always been, regarded in the United States as one of the highest and most important governmental functions of a republican form of government. Cochran v. Louisiana State Board of Education, 281 U. S. 370; Phillips v. Virginia University, *supra;* Hjorth Royalty Co. v. Trustees of University of Wyoming, *supra;* Board of Education v. State, 26 Okla. 366, 370; Scown v. Czarnecki, 264 Ill. 305. Public schools and universities have been maintained and operated from the earliest colonial times. They were conducted by the colonies. Nelson's Encyclopedia, Vol. 10, p. 91; The Americana, Vol. 27, History of University of Columbia; Vol. 29, p. 337; Ellwood P. Cubberly, "An Introduction to the Study of Education," pages 1-4, 62-3, 357-8. They were authorized by the early State constitutions and colonial laws. (The following page references are to "The Federal and State Constitutions, Colonial Charters and other Organic Laws of the United States," compiled under an order of the United States Senate by Ben. Perley Moore, 1878.) Constitutions of Georgia, 1777, Art. LIV, p. 383; Massachusetts, 1780, Art. III, p. 957, Chap. V, p. 970; New Hampshire, 1784, p. 1291; North Carolina, 1776, Art XLI, p. 1414; Vermont, 1777, Sec. XL, p. 1865; 1786, Sec. XXXVIII, p. 1874; 1793, Sec. 41, p. 1882; Pennsylvania Frames of Government, 1683, Sec. XII, p. 1521; 1696, p. 1535; Constitutions of 1776, Sec. 44, p. 1547; 1790, Art. VII, p. 1553. In 1806 (2 Stats. 381) the Federal government required Tennessee to set

aside large tracts for two colleges and for academies in each county. In enabling acts admitting States into the Union the Federal government has consistently set aside lands for the exclusive use of public schools, seminaries and universities. Ohio, 1802, 2 Stats. 173; Indiana, 1816, 3 Stats. 289; Illinois, 1818, 3 Stats. 428; Alabama, 1819, 3 Stats. 489; Missouri, 1820, 3 Stats. 545; Arkansas, 1836, 5 Stats. 58; Iowa, 1845, 5 Stats. 789; Wisconsin, 1846, 9 Stats. 56; Minnesota, 1857, 11 Stats. 166; Oregon, 1859, 11 Stats. 383; Nevada, 1864, 13 Stats. 30; Nebraska, 1864, 13 Stats. 47; Colorado, 1875, 18 Stats. 474; Oklahoma, 1906, 34 Stats. 267.

Thomas Jefferson in 1779 introduced in the legislature of Virginia his famous "bill for a more general diffusion of knowledge" which embodied a plan for a public school system in that State. (Edgar W. Knight—"Public Education in the South," page 114.) In his first message to Congress in 1790, Washington pointed out the importance of education for the maintenance of the security of the Constitution.

Congress at an early date recognized that public instruction is a governmental function. In the Act of July 13, 1787, establishing the Northwest Territorial Government it provided "religion, morality and knowledge, being necessary to good government and the happiness of mankind, schools and the means of education shall forever be encouraged."

In Texas the maintenance of public schools and universities was considered a governmental function before the Republic of Texas became a State. The thought of creating a State University originated at least as early as January 26, 1839, when the Congress of the Republic by an Act of that date (Laws of 1839, p. 134) required

the President to set aside fifty leagues of public land for the establishment and endowment of two colleges or universities thereafter to be created. This was followed by the Act of February 11, 1858 (Laws of 1858, p. 148), creating a University of Texas and setting aside additional lands and appropriating $100,000 for its establishment, which Act recited that:

> "From the earliest times, it has been the cherished design of the people of the Republic and of the State of Texas, that there shall be established, within her limits, an institution of learning, for the instruction of the youths of the land in the higher branches of learning * * * and as a means whereby the attachment of the young men of the State to the interest, the institution, the rights of the State, and the liberties of the people, might be encouraged and increased, and, to this end, hitherto liberal appropriations of the public domain have been made."

As heretofore stated, the present University of Texas was actually established in 1881 pursuant to the constitutional mandate of 1876.

The maintenance of the University of Texas is therefore clearly a governmental function. The contentions of respondent to the contrary were overruled by both the lower courts.

It is therefore submitted that the State of Texas has the sovereign right to realize upon its oil and gas resources under these lands free from any control or impediment on the part of the United States, and any attempt by the latter to interfere therewith is derogatory of the State's dignity, subversive of its powers and repugnant to its paramount authority.

II.

The leases under which petitioner produced the oil and gas from the public domain of the State of Texas covered thereby, and petitioner as the owner thereof, are the means, agencies and instrumentalities chosen by the State of Texas for developing the State's oil and gas, and the United States had no power or authority to levy the income taxes on the income of petitioner from its leases.

Petitioner's income, upon which it paid the income taxes sued for, was derived solely from its operations under oil and gas leases granted under the Act of March 16, 1917. Laws of 1917, Chap. 83, p. 158, 35th Leg. (Appendix p. 87), upon university lands. (Copies of these leases are set forth at pages 13 and 17 of the Record.)

With the development of the oil industry, it became apparent that parts of the State's public lands probably contained oil, gas and other minerals. The State, not desiring to carry on itself operations for oil and gas, which are, as is well known, of a more or less speculative character in unproven territory, but desiring to have the mineral resources under these lands developed in order that it and its university might derive a benefit therefrom, enacted a series of laws under which oil and gas permits and leases might be granted.

The sole purpose of the State in granting these leases was to realize upon its interest in the minerals through its reserved royalties. This is obvious from the leasing acts themselves and the frequent legislation on the subject. Petitioner alleged such to be its purpose (R. 6, par. VIII), and it was admitted in the agreed Statement of Facts. (R. 25, par. VIII.) The end sought by the

State was entirely different from that in the outright sale of public lands to homesteaders. The purpose in the latter case is to encourage settlers and gradually to transfer the public domain into the hands of private owners instead of having them perpetually retained by the State. In those cases the State after the sale is no longer interested in the lands and retains no connection with them. As to these oil leases, however, the State is not granting them for the private benefit and profit of the lessee. Its end is to have the minerals brought to the surface where they may be converted into money. Its royalty portion of the oil at the surface, produced at the expense and risk of the lessee, is of more value to the State than all the oil below the ground. It therefore grants these leases for the purpose of obtaining this royalty, and lets the lessee have its portion of the oil as compensation for its services and risks in producing the State's royalty part.

We will briefly review the history of the Texas Leasing Acts. The first was that of April 9, 1913 (Ch. 173, p. 409, 33rd Leg.). This embraced all public lands of the State, but, as it had certain practical defects, it was superseded by that of 1917 and will not be referred to further. However in Section 1 it set forth the State's policy as follows:

> "It is declared to be the policy of the State to open all such lands to mineral prospecting and development on a system providing for the payment into the State Treasury to the credit of the permanent free school, university, asylum and other funds, of certain rents and royalties upon the gross output of any minerals or mineral product thereon."

The 1913 Act was repealed and superseded by that

of March 16, 1917, Ch. 83, p. 158, 35th Leg. (Appendix page 87.) Petitioner's leases were issued under the 1917 law. Its provisions will be discussed more in detail later, but under it the State retained in all leases a royalty equal to one-eighth of the gross production of oil and one-tenth of the gas. The end sought was further stated in the emergency clause:

> "The fact that portions of the mineral statute are so incongruous and difficult of interpretation as to be almost inoperative and the fact that *a law clear in its terms and ample to secure the development of the State's mineral wealth is badly needed* * * * creates an emergency," etc.

The emergency clause of the Act of February 1, 1921 (Ch. 6, p. 7, 37th Leg.), which merely extended the time for prospecting under permits, recited:

> "The fact that the term of the permit is too short to secure adequate development of the mineral resources of the State, creates an emergency."

This Act of 1917 has been amended from time to time in minor particulars, and still remains the fundamental law governing leases on all State lands except those of the university.

However, in 1924, oil was first discovered on university lands by those who later incorporated petitioner. (Petitioner's two leases were issued in May and July, 1924, after discovery of oil under the underlying prospecting permits.) Special legislation governing the leasing of university as distinguished from other State lands ensued. The 1917 Act was then superseded by that of March 10, 1925, Ch. 71, p. 225, 39th Leg. (Appendix, p. 101.) This and the later Acts embraced only university lands. The 1925 Act provided for com-

petitive bidding for leases. The royalties were fixed at one-eighth of the value of the oil and gas, but there was competition as to the cash bonuses to be paid. In 1927 the constitutionality of the 1925 Act was attacked in the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489, hereinafter referred to, and to prevent the 1917 Act being revived if the 1925 Act were declared void, the legislature by the Act of March 31, 1927, Ch. 249, p. 368, 40th Leg. (Appendix, p. 109), provided no leases should be granted on university lands if the 1925 Act were stricken down.

A controversy arose concerning certain sales of leases to be held in January, 1929, and the legislature, acting under the recited "necessity for the immediate protection of the university funds," by the Act of January 11, 1929, Ch. 2, p. 6, 41st Leg. (Appendix, p. 111), repealed the law of 1925, withdrew all university lands from leasing "until such time as the legislature may enact laws deemed adequate for the protection of the university funds," and attempted to prevent the sales advertised for January.

The present leasing law is that of March 29, 1929, Ch. 282, p. 616, 41st Leg. (Appendix, p. 114.) Prior to that law all leases were issued by the Commissioner of the General Land Office. This Act placed the leasing in the hands of a board consisting of the Commissioner and two members of the Board of Regents of the university. Leases are let under competitive bidding, the bids specifying both the royalties and the cash bonus to be paid. A minimum royalty of one-eighth of the oil and gas is provided in the Act with authority given to the board to increase this minimum as to any tract or tracts. The board may reject all bids.

This brief review of the history of the Leasing Acts demonstrates the efforts of the State to obtain as great returns from its minerals as possible, and shows its purpose in granting leases is to realize upon its own minerals and not merely to allow private lessees to produce them for their individual profit.

This has been further emphasized by the State in filing its brief as *amicus curiae* urging the importance to the State of a decision in this case in favor of petitioner as a reason why the certiorari should have been granted. The State is vitally concerned in this petitioner's success as an agency of the State, and being such agency, the State is interested in protecting it from interference and taxation by another government.

The general provisions of the Act of 1917 may be summarized as follows: All of the university lands, among others, were opened for prospecting for and developing the oil and gas resources and other minerals. An applicant was allowed under certain conditions to obtain a permit to prospect for oil and gas on the land covered by his permit upon the payment of ten cents per acre. Upon oil or gas being discovered within a prescribed time, and the payment of two dollars per acre, the Commissioner of the General Land Office was directed to issue a lease for a term of ten years with an option of renewals. An annual payment of two dollars per acre was required. In addition, the lessee was required to pay the State each month a royalty equal to one-eighth of the gross production of oil and one-tenth of the value of the meter output of all gas disposed of off the premises. The Commissioner was given authority to incorporate in the leases such other terms as he deemed important to protect the interests of the

State, including the right to require the lessee to drill offset wells to prevent drainage by wells on adjacent private lands. No oil or gas could be disposed of by the operator until he obtained a lease.

Petitioner's leases, in addition to reserving the statutory royalties and incorporating the provisions required by the statute, provided among other things: (1) the lessee was required to proceed with reasonable diligence to develop and operate the property for oil and gas, and to operate each producing well so as to produce the oil and gas therefrom; (2) it was required to drill, either voluntarily or on request by the Commissioner, offset wells to prevent drainage by wells on private lands; (3) if the lessee failed to proceed with due diligence to develop and operate the properties or to produce the oil that could be produced from wells, or to pay any royalties, or to comply with any other regulations of the Commissioner reasonably necessary for carrying out the provisions of the statute, the leases were subject to forfeiture.

The State of Texas, in the exercise of its own unrestricted discretion, may decide upon the manner in which its minerals shall be produced. It may produce them directly through its own operations, employing drilling crews and other servants just as it performs many of its other functions. The experience of the oil industry, however, has demonstrated that the interests of a landowner are best subserved by his having his minerals developed through leases rather than through his own efforts. He receives a portion of the gross production through his reserved royalties, which is delivered to him with no expenditure or risk. The lessee as its compensation for thus producing the landowner's royalty

oil receives the remaining part. The State in pursuing this method has done only what the ordinarily prudent private individual would do, and has been doing for centuries, in connection with various other kinds of minerals. The oldest tin mines of England, once worked by the Romans, were operated under the same system. Theisen v. Robison, 117 Tex. 489, 504. The United States has preferred to develop the minerals upon Indian lands in Oklahoma through lessees rather than through direct government operations.

But the questions of whether petitioner and other oil and gas lessees of these State lands are such agencies of the State that may not be taxed by the United States, and whether an income tax upon their net income is one of the forbidden taxes, have been foreclosed by this Court in its decisions involving the right of Oklahoma to tax lessees of Indian lands holding leases from the Federal government. This Court has consistently held them to be governmental agencies and exempt from various kinds of taxes attempted to be levied by Oklahoma, including an income tax similar to the one involved in this cause. These cases are Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292 (a tax on the gross production of a mine); Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522 (a tax upon the leases); Howard v. Gipsy Oil Company, 247 U. S. 503; Large Oil Company v. Howard, 248 U. S. 549, reversing the Supreme Court of Oklahoma decision in 63 Okla. 143 (a tax on the gross production after deduction of the royalty); Gillespie v. Oklahoma, 257 U. S. 501 (an income tax upon the net income of the lessee); Jaybird Mining Company v. Weir,

271 U. S. 609 (an ad valorem tax on the minerals mined).

The applicable rules are succinctly stated by Justice Holmes in the Gillespie case as follows:

> "The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist and make laws. New York, New Haven & Hartford R. R. Co. v. New York, 165 U. S. 628. Diamond Glue Co. v. United States Glue Co., 187 U. S. 611, 616. The rule as to instrumentalities of the United States, on the other hand, is absolute in form and at least stricter in substance. Williams v. Talladega, 226 U. S. 404, 416, 417, 419. Johnson v. Maryland, 254 U. S. 51, 55. 'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon income from the leases is not long.
>
> "In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is *pro tanto* void; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 158 U. S. 601; rule lately illustrated by Evans v. Gore, 253 U. S. 245; and applied in a case somewhat like the present by the Supreme Court of Hawaii, Oahu R'y & Land Co. v. Pratt, 14 Hawaii 126. Whether this property could be taxed in any other form or not, it cannot be reached as profits or income from leases such as those before us."

Further quotations from these opinions will not be made. They decisively settle the fundamental principles involved in this cause. They establish the two propo-

sitions: first, that an oil and gas lessee holding under one government falls within that class of instrumentalities that may not be taxed by the other government; and, second, that an income tax on the lessee's income is one of the forbidden taxes.

Petitioner, as a lessee from the State of Texas, is to the same extent and for like reasons exempt from the Federal income tax. In The Collector v. Day, 78 U. S. (11 Wall.) 113, 127, this Court said:

> "And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, exempt equally from Federal taxation? Their unimpaired existence in the one case is as essential as in the other. * * * In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; and any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government. Of what avail are these means if another power may tax them at discretion?"

In Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584, it is stated:

> "As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State."

See also United States v. Railroad Company, 84 U. S.

(17 Wall.) 322, 327; Ambrosini v. United States, 187 U. S. 1, 7.

The decision in the Gillespie case as to the Federal lessee applies with equal force to the petitioner in this cause. Under that case this State lessee is an instrumentality of the State, and as such the United States may not tax its income from its leases.

These Oklahoma cases, and particularly Gillespie v. Oklahoma, have been frequently referred to by this Court as being among the leading authorities on the question of exemption of governmental instrumentalities. Long v. Rockwood, 277 U. S. 142, 148; The Macallen Company v. Massachusetts, 279 U. S. 620, 627; Northwestern Mutual Life Insurance Company v. Wisconsin, 275 U. S. 136, 140, in which it was said:

> "Certainly since Gillespie v. Oklahoma, 257 U. S. 501, 505, it has been the settled doctrine here that where the principal is absolutely immune, no valid tax can be laid upon income arising therefrom."

In Panhandle Oil Company v. Knox, 277 U. S. 218, they are referred to as follows:

> "The States may not burden or interfere with the exertion of national power or make it a source of revenue or take the funds raised or tax the means used for the performance of Federal functions. * * * Choctaw & Gulf R. R. Co. v. Harrison, 235 U. S. 292. Indian Oil Co. v. Oklahoma, 240 U. S. 522. * * * The strictness of that rule was emphasized in Gillespie v. Oklahoma, 257 U. S. 501, 505."

When the underlying reasons and the long line of decisions of this court, beginning with M'Culloch v. Maryland, 4 Wheat. 316, are considered, it inevitably follows that one government may not tax the other govern-

ment's oil and gas lessees. We will not review in detail the numerous decisions of this court, but desire to call attention merely to a few typical extracts from its opinions:

"There is no express provision for the case, but the claim has been sustained on a principle which so entirely pervades the Constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it without rending it into shreds. * * *

"These are, 1st, that a power to create implies a power to preserve. 2nd, that a power to destroy, if wielded by a different hand, is hostile to, and incompatible with, those powers to create and to preserve. 3rd, that where the repugnancy exists, that authority which is supreme must control, not yield to that over which it is supreme. * * *

"The court has bestowed on this subject its most deliberate consideration. The result is a conviction that the States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government." M'Culloch v. Maryland, 4 Wheaton 316.

"Congress has power 'to borrow money on the credit of the United States.' The stock it issues is the evidence of a debt created by the exercise of this power. The tax in question is a tax upon the contract subsisting between the government and the individual. It bears directly on that contract, while subsisting and in full force. The power operates upon the contract the instant it is framed, and must imply a right to affect that contract. * * *

"The right to tax the contract to any extent, when made, must operate upon the power to borrow be-

fore it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of the government. It may be carried to an extent which shall arrest them entirely." Weston v. City Council of Charleston, 27 U. S. (2 Peters) 449, 465, 466, 468; Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 586; The Macallen Company v. Massachusetts, 279 U. S. 620, 624.

"Is not compensation the means by which his services are produced and retained? It is true it becomes his when he has earned it. If it can be taxed by a State as compensation, will not Congress have to graduate its amount, with reference to its reduction by the tax? Could Congress use an uncontrolled discretion in fixing the amount of compensation, as it would do without the interference of such a tax?" Dobbins v. Commissioners of Erie County, 41 U. S. (16 Peters) 435, 448.

"And it must be always remembered, if the right to impose a tax at all exists on the part of the other government, 'it is a right which in its nature acknowledges no limits.' And the principle is equally true in respect to every other power or function of a government subject to the control of another." Bank of Commerce v. New York City, 67 U. S. (2 Black) 620, 634.

"This carries with it an exemption of those agencies and instruments from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. Their operation may be impeded and may be destroyed, if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other." United States v. Railroad Company, 84 U. S. (17 Wall.) 322, 327, 328.

"Applying this language to these municipal securities, it is obvious that the taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution." Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 586.

"And to tax the bonds as property in the hands of the holders is, in the last analysis, to impose a tax upon the right of the municipality to issue them." Farmers & Mechanics Savings Bank v. Minnesota, 232 U. S. 516, 526.

"With regard to taxation, no matter how reasonable, or how universal and undiscriminating, the State's inability to interfere has been regarded as established since M'Culloch v. Maryland, 4 Wheat. 316. The decision in that case was not put upon any consideration of degree but upon the entire absence of power on the part of the States to touch, in that way at least, the instrumentalities of the United States; 4 Wheat. 429, 430; and that is the law today. Farmers & Mechanics Savings Bank v. Minnesota, 232 U. S. 516, 525, 526." Johnson v. Maryland, 254 U. S. 51, 55.

"The principle set forth a century ago in Weston v. Charleston, 2 Pet. 449, 468 (7 L. Ed. 481), has never since been departed from by this court:

"'The right to tax the contract to any extent, when made, must operate upon the power to borrow, before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government; to any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them

entirely.' Home Savings Bank v. Des Moines, 205 U. S. 503, 513; 27 S. Ct. 571, 51 L. Ed. 901 . . .

"Not only may the power to tax be exercised oppressively, but for one government—State or national—to lay a tax upon the instrumentalities or securities of the other is derogatory to the latter's dignity, subversive of its powers, and repugnant to its paramount authority. See California v. Central P. R. Co., 127 U. S. 1, 41; 8 S. Ct. 1073 (32 L. Ed. 150)." The Macallen Company v. Massachusetts, 279 U. S. 620.

The foregoing quotations apply themselves to the present case without the need of assisting comment. These Federal income taxes are stricken down because they are an impediment upon the power and right of the State of Texas to have its own minerals developed for its use and benefit, in which activity it is beyond the control of the United States. The right to tax these lessees would operate upon the power of the State to grant the leases before that power was exercised, and would have a sensible influence upon the terms the State could require the lessees to accept. The net income of the lessee is the compensation received by it from the State for its services in producing the State's royalty portion of the oil. If the United States may reduce this compensation through the income tax, the State would have to increase it by reducing its reserved royalties, and could not use its uncontrolled discretion in fixing their amount. There is no question of degree of taxation, whether it is burdensome or not, or whether it is universal and undiscriminating.

This burden on the State's lessee is a continuous one, and is even more pronounced than in the case of State or municipal bonds. Just as the power to tax the inter-

est on bonds would affect the rate of interest the State would have to pay and the price for which they could be sold, in the same way the tax would affect the amount a lessee would be willing to pay for the leases (corresponding to the selling price of bonds), and the royalty the State could reserve (corresponding to the interest rate on bonds). Furthermore, when bonds are sold, the contract between the State and the bondholder is completed. Regardless of future changes in Federal income tax rates, the rate of interest on the bonds would remain the same and the State would have received the proceeds of their sale. In the case of these leases this burden and interference by the Federal Government is a continuous one, at all times hindering and impeding the lessee in its operations of the properties and reducing the gross production with the resulting diminution of the amount derived by the State from its royalties.

If the Federal Government may levy this income tax, it is in the position of saying to the State that it must be carried for an interest in all leases executed by the State on its own lands. Such an interest is of a more stringent character than the ordinary working interest. The owner of the usual working interest obtains no part of the oil until the operating lessee has recouped all his expenses, and even then the amount of the working interest is definite and certain. But the interest of the Federal government through its income tax is uncertain and indefinite, the amount being subject to fluctuations each year, dependent not on the will of the State or of the lessee, but upon that of the Federal government. Likewise, the lessee cannot tell during any year what the Federal government's interest will be until after the operations for that year have been entirely concluded.

For example, the rate of the income tax for the calendar year 1925 was not fixed until the 1926 Act was approved on February 26, 1926. Also, the interest of the Federal government is not a true working interest. It is true under the present income tax Act of 1928 losses may be carried forward as a deduction against gross income, but not for more than two years. There is nothing to require the Federal government to allow past losses in past years to be carried forward against gross income in future years. If it may levy this income tax, it may participate in the net income for any year without allowing the lessee to recoup any past losses.

All of these considerations clearly demonstrate the burden this tax places upon the lessee in its operations. It reduces the funds available for further drilling and development of the properties. It makes it uncertain what net return the lessee will derive from the lease, and thus makes for uncertainty as to what additional amounts the lessee can afford to invest in the development and operation of the lease. It is common knowledge that every reduction in the price of crude oil is followed immediately by a decrease in drilling activities generally, and every increase speeds up exploration and development work. The Federal income tax has a similar influence on all such operations. Push this tax to a relatively high level, and drilling operations are immediately curtailed. It must be borne in mind the solution of this question does not depend upon whether the particular rate of income taxation is high or not. If any such tax may be levied, the courts will not inquire whether the specific rate is reasonable or not, and the Federal government may make the rate so high that no lessee, even after obtaining any lease from the State, could af-

ford to operate under it, and thus the State would be prevented from obtaining the development of its mineral resources through these leases, and would be forced to undertake the production of these minerals directly through its own operations. That such may well be the case is pointed out by this Court in Loan Association v. Topeka, 87 U. S. (20 Wall.) 655, where the court said in part:

> "It was said by Chief Justice Marshall, in the case of McCulloch v. The State of Maryland, that the power to tax is the power to destroy. A striking instance of the truth of the proposition is seen in the fact that the existing tax of ten per cent imposed by the United States on the circulation of all other banks than the National banks drove out of existence every State bank of circulation within a year or two after its passage."

However, all of these considerations were taken into account by this Court when it held in Gillespie v. Oklahoma, *supra,* and the other Oklahoma cases, that oil and gas lessees are within that class of governmental agencies that may not be taxed by another government, and nothing further need be said upon that point. They do not fall within the taxable class as illustrated by Metcalf & Eddy v. Mitchell, 269 U. S. 514, where the taxpayer's work was not of a permanent or continuous character and his employment was more in the nature of simply a contract for a single, casual, or isolated specific piece of work. Petitioner's leases, however, continue as long as oil or gas is produced, and its services are of a continuous nature. The State is interested in the success of each day's operations as its returns are measured by the amount of oil or gas produced that day. The leas-

ing Act provides in many details how its operations shall be carried on, and under the leases it is required to observe all regulations promulgated by the Commissioner of the General Land Office.

Oklahoma vigorously attacked the claim of the lessees to be governmental agencies, but its contentions were consistently overruled. In Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522, 524, it asserted that the oil company occupied "the position of an independent contractor, acting for itself and in its own behalf, in a contract with the Osage Indian Tribe," and therefore the relation of principal and agent between it and the government did not exist. This Court overruled that argument as the question does not depend upon whether the technical relation of principal and agent exists.

In Gillespie v. Oklahoma, 257 U. S. 501, 502, it argued that the income tax "attaches after all of the functions of the Federal agency have been performed freely and untrammeled, after the lessee has received his compensation and after, with the close of his year's business, it is found that he is possessed of a net income." This Court likewise refused to subscribe to that position.

The 16th Amendment to the Constitution did not extend the taxing power of the United States to new or excepted subjects, but merely abrogated the requirement in Section 2, Article I, that direct taxes be apportioned among the several States. Brushaber v. Union Pac. R. R. Co., 240 U. S. 1, 17-19; Stanton v. Baltic Mining Co., 240 U. S. 103, 112-113; Peck & Co. v. Lowe, 247 U. S. 165, 172; Evans v. Gore, 253 U. S. 245. That amendment therefore had no effect upon the exemption of governmental agencies from taxation.

We submit, therefore, that under Gillespie v. Oklahoma, *supra*, and the other Oklahoma cases, and the reasoning that necessarily led to the holdings in those cases, petitioner is such an agency and instrumentality of the State of Texas as is exempt from the Federal income tax.

As the Circuit Court of Appeals has referred to the decision in Theisen v. Robison, 117 Tex. 489, we will discuss it briefly. That court referred to it as follows:

> "That legislation (referring to the 1925 Leasing Act) was attacked as being in violation of a constitutional provision which permitted only the sale of university lands; but the Supreme Court of Texas held that the statutory leases constituted sales, and that the oil and gas when appropriated by the lessees formed no part of the university's permanent fund. Theisen v. Robison, 8 S. W. (2) 646. The royalty interest of the State is not involved, as the income tax act does not attempt to reach it. * * *
>
> "The State of Texas has no occasion to claim immunity for itself, and has not sought to exempt lessees of its university lands from Federal income taxation. On the contrary, it has sold the mineral rights here involved and has provided that the rights of the purchaser or lessee 'shall be subject to taxation as is other property.' It cannot be doubted that the sovereign has the power to subject interests which it has sold in public lands to taxation." (R. 48.)

At this point we will deal primarily with the part referring to these minerals as having been sold. We will later demonstrate that no affirmative action by the State exempting these lessees from Federal taxation is necessary, and that the State by providing that the leases "shall be subject to taxation as is other property" referred only to State and not Federal taxation.

Respondent has argued in the lower courts that under the Theisen case the State has sold these minerals, and petitioner's income from the sale of its portion of the oil is in the same class as any profit an ordinary homesteader might make on the resale of lands he had bought from the State, and therefore petitioner's income is subject to Federal taxation. The District Court considered the effect of the Theisen case (see R. 37, listing it as one of cases considered), and held it did not have the effect attributed to it by respondent. The Circuit Court of Appeals also considered it and in substance sustained the District Court on that point. If it had differed with the District Court, it would have held that petitioner was not a State instrumentaliy. It did not do this, but based its decision solely on its construction of Section 27 as a waiver by the State of the exemption petitioner otherwise was entitled to.

The difference between a resale by a homesteader of land bought from the State and the income of the petitioner from the sale of oil produced by it under State leases is obvious. It has always been true that ordinary public land when sold by one government becomes subject to taxation by the other government because after its sale the former has no longer any connection with or interest in the land. This was pointed out in the early case of Weston v. City of Charleston, 2 Peters 449, 468:

> "*When lands are sold, no connection remains between the purchaser and the government.* The lands purchased become a part of the mass of property in the country with no implied exemption from common burthens. All lands are derived from the general or particular government, and all lands are subject to taxation. Lands sold are in the condi-

tion of money borrowed and repaid. Its liability to taxation in any form it may then assume is not questioned. The connection between the borrower and the lender is dissolved."

In Van Brocklin v. Tennessee, 117 U. S. 151, 169:

"And the reason why, after lands have been duly entered at the land office, and everything has been done to entitle the party to a patent, they have by long usage, confirmed by the decisions of this court, been considered, before the patent is actually taken out, as subject to State taxation, is that *the United States have nothing but the naked legal title, and the lands are in truth no longer public property*, but have become private property."

But the connection between the State and these lessees was not dissolved at the granting of these leases. On the other hand the connection between the two began, instead of ending, with the granting of the leases. The State is vitally connected with the lessee's operations every minute as it gets the proceeds of one barrel of oil out of every eight produced by the lessee, and the more the lessee produces the greater the return to the State.

The respondent has quoted particularly the following portion of the opinion in the Theisen case, at page 511 of 117 Tex.:

"The leases convey all the oil and gas in granting the right to find, produce, and appropriate all of them, in consideration of the payment of stipulated sums, and also the value of a stated fraction of the oil and gas produced. The oil and gas when appropriated form no part of the university's permanent fund. While in place, before being sold, the oil and gas were potential assets of the fund. Like any

> other seller, the State, after parting with its title, no longer owns that which it has sold, but the State receives and turns over all the proceeds of sale when it receives and turns into the permanent university fund the royalties and other payments required by the Acts. As a result of the sale, the purchaser owns the oil and gas, and the university permanent fund owns the entire proceeds of their sale."

As stated above both the lower courts correctly held that case did not apply. We will discuss what the Theisen case actually decided.

Section 11 of Article VII of the Constitution provided that the lands set apart for the university and their proceeds should constitute "a permanent university fund," which fund must be invested and kept intact. Section 12 then provided:

> "The land herein set apart to the university fund shall be *sold* under such regulations, at such times, and on such terms as may be provided by law."
> • • •

After the 1925 Leasing Act was passed Theisen filed with Robison, the General Land Commissioner, an application under the 1917 Act for a mineral prospecting permit for certain university land, which Robison refused as the 1917 Act had been repealed by that of 1925. Theisen then sought a mandamus in the Supreme Court to require Robison to issue the permit on the ground that the 1925 Act was unconstitutional and that of 1917 was therefore still in effect. The Board of Regents of the university intervened and contended both the 1917 and 1925 Acts were void as violating the constitutional provision that the lands "shall be sold." Such a position was a direct attack on the validity of

all leases theretofore granted, including those of petitioner, and it intervened to protect its rights. There was only one question involved and that was whether the Leasing Acts were constitutional. As the Supreme Court said at page 499:

> "The principal question in the case is whether the Acts of 1917 and 1925 violate Section 12 of Article 7 of the Constitution, which reads as follows:
>
> "'The land herein set apart to the university fund shall be *sold* under such regulations, at such times, and on such terms as may be provided by law' * * *."

The grounds of the attack were summarized by the court as follows (p. 502):

> "The two acts are mainly assailed on the ground that they provide for a permit or lease conferring on the permittee or lessee no greater right than a mere license, exercisable at the permittee's or licensee's option, to prospect for oil or gas, when the Constitution mandatorily requires the legislature to dispose of the university lands by sale only and forbids the grant of a mere optional license."

There are two lines of argument as to the nature and effect of an oil and gas lease. One construction is that, as oil and gas are fugitive minerals, the owner of the land has no title to them while under the ground and obtains title only to such as may be produced and reduced to possession, and his title vests only when they are thus brought to the surface. As the landowner thus has no title to the oil and gas in place, his lease cannot and does not transfer to the lessee any title whatsoever to them while in place, and the lessee obtains only a license to prospect for and produce the oil and gas when

found and obtain title to such oil as may be produced. Under the other line of argument the landowner has a present vested title to the oil and gas in place, and this title passes to the lessee immediately upon the execution of the lease. The only difference between the two constructions is that under the second rule the title to the minerals passes to the lessee and upon a forfeiture of the lease the title reverts to the landowner, while under the first rule this shifting of title does not occur. The Supreme Court of Texas has long since adopted the second construction of oil leases, and the substance of its holding in the Theisen case was that, since the leases conveyed a present title to the minerals in place, and a conveyance of a title is included in the definition of a "sale," these leases complied with the constitutional provision that the university lands must be "sold."

The legal grounds upon which the Supreme Court sustained the Leasing Acts may be summarized as follows: (1) The word "sold" as used in the Constitution should be given the meaning it had at common law. (2) For centuries the uniform method by which landowners converted their minerals into money has been the execution of leases with a royalty reserved. (3) The court in Benavides v. Hunt, 79 Tex. 383, Texas Company v. Daugherty, 107 Tex. 226, and Stephens County v. Mid-Kansas Oil & Gas Company, 113 Tex. 160, had held that an ordinary oil and gas lease operated to convey the title to the minerals in place immediately to the lessee, subject to reversion to the lessor on forfeiture of the lease. (4) As title to the minerals in place thus passed to the lessee immediately, such a lease was a present conveyance of an interest in land, and, being such a con-

veyance, constituted a sale within the common law meaning of that term. (5) The leases authorized by the Leasing Acts had the same effect, the Supreme Court saying:

> "It is unthinkable to treat the ordinary lease as conveying minerals in place and to refuse to give that effect to the grants authorized by these Acts."

(6) These leases therefore, in passing the legal title to the oil in place to the lessee, constituted sales within the meaning of Section 12 of the Constitution.

The relation existing between these lessees and the State is the same as that between the lessor and lessee in the ordinary mineral lease of private lands. Upon this the Supreme Court said in Greene v. Robison, 117 Tex. 516, 535 (decided the same day as the Theisen case):

> "A sale or lease by the State is subject to the same rules of law that are applied to ordinary business or commercial leases. In the absence of an express provision, there is an implied covenant for exploration, development, and operation. Freeport Sulphur Co. v. American Sulphur Royalty Co., not yet reported (p. 439 ante, 6 S. W. 2d series, 1039); and upon abandonment of the property for the purposes of the lease, the oil and gas reverts to the vendor or lessor, as was held in the cases of Grubb v. McAfee, 109 Texas 527, 212 S. W. 464, and Texas Co. v. Nelson Davis, 113 Tex. 321, 254 S. W. 305."

There is no substantial difference in oil and gas leases under either rule of construction, as pointed out in Stephens County v. Mid-Kansas Oil & Gas Company, 113 Tex. 160, 173, where the Supreme Court quoted the following from Hardwicke on "Innocent Purchaser of Oil and Gas Lease":

"'A lessee has no more privileges under one type of instrument than he has under the other. The instruments simply provide for the development of the land and distribution of the minerals which are discovered. For this reason, the parties usually attach little or no significance to the language in the granting clause. The thing that the landowner is interested in giving, and the thing that the operator is interested in obtaining, is the right to enter on the land, to the exclusion of all others, for the purpose of discovering and producing minerals that exist, and to distribute such minerals in accordance with the lease, usually one-eighth to the landowner and seven-eighths to the operator'."

The Circuit Court of Appeals referred to the fact that in the Theisen case the Supreme Court of Texas held that the oil and gas, when appropriated by the lessees, formed no part of the university's permanent fund. This might possibly lead to the erroneous belief that, after the leases are executed, the State has no further interest in the oil. In the usual private oil lease the royalty reserved is a specified fraction of the oil itself, and the lessor may require the lessee to deliver to him his royalty oil in kind. Even under such leases, however, the lessee customarily sells the lessor's royalty oil along with the lessee's, and the purchaser remits directly to the lessor the proceeds of the royalty oil. In the 1917 State leases the royalty reserved was not one-eighth of the oil in kind but a royalty of one-eighth of the value of the gross production of petroleum. The State preferred for the lessee to attend to the sale of all the oil and be responsible for the State's receiving one-eighth of the proceeds. As the court held title to all the oil in place passed to the lessee, it logically stated that, as long as the lease remained in effect, the lessee

owned all the oil and the university fund owned one-eighth of the proceeds of its sale. For the purposes of the present case it is immaterial whether the State's royalty was one-eighth of the oil in kind or one-eighth of the value of the gross production.

Whether the leases are construed as passing title to the oil in place or not is immaterial. Under either construction title to the lessee's portion of the oil vests at least at the moment it is produced and reduced to possession. Therefore when it sells the oil, it has in the same sense resold oil which it has purchased. If its income is not subject to the Federal income tax in the case where it obtains title only as the oil pours from the mouth of the well, the fact that its title to the oil vested while the oil was still below the surface would not alter the situation at all.

The State intended the relation between it and these lessees to be that existing between the ordinary lessor and lessee of private mineral lands, regardless of whether the leases would be called technically sales or any other name. Its purpose was that of any private landowner—the receipt of royalties free of the expense and risk of producing them. It will be noted how frequently the Supreme Court in the Theisen case, the legislature in the Leasing Acts, and the leases themselves use the terms "lease," "leases," and "lessee." They do not speak of the State as "vendor" or "seller," or of the lessee as "vendee" or "purchaser." They are continuously referred to as "lessor" and "lessee," and the instruments as "leases." Petitioner's leases are on their faces designated "Oil and Gas Lease No. 8560," (R. 13), and " Oil and Gas Lease No. 8607." (R. 17.)

The Theisen case decided only one point and that was

that the Leasing Acts were not unconstitutional, and that is the only point upon which it is binding in any way upon this Court. The question of whether the lessees were such agencies of the State as are exempt from Federal taxation was not before the court in that case.

Just as this Court said in reference to national banks in Farmers & Mechanics National Bank v. Dearing, 91 U. S. 29:

> "Of the degree of the necessity for creating them Congress is the sole judge,"

and again in United States v. Railroad Company, 17 Wall. (84 U. S.) 322, 330:

> "Should it (the city) endeavor by the expenditure of this money or this credit to bring this vast business into its own State, and make its commercial metropolis great and prosperous, or should it refuse to incur hazard, allow other States to absorb this commerce, and Baltimore to fall into an inferior position? This was a question for the decision of the city under authority of the State. It was a question to be decided solely with reference to public and municipal interests."

so here, as to all questions concerning the creation of these leases and their terms, the relation to exist between the State and its lessees, whether the title to all the minerals in place should be vested in the lessee subject to forfeiture or whether the State should retain title thereto until actually produced, the State was the sole judge.

The United States retains no title to an invention when it grants a patent, yet a State may not tax the income from it. Long v. Rockwood, 277 U. S. 142. It

has no financial interest in national banks and owns no stock in them, but they may not be taxed by the States except when permitted by Congress. Owensboro National Bank v. Owensboro, 173 U. S. 664. It retains no title to franchises granted to railroad companies, but the States may not tax those franchises. California v. Central Pacific Railway Co., 127 U. S. 1. It owns no interest in telegraph companies, but their services to the Federal government may not be taxed by the States. Telegraph Co. v. Texas, 105 U. S. 460. Lessees of Indian oil-lands are independent contractors but are free from State taxation. Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522. Thus the mere legal relationship between the State and petitioner as to the legal title to the oil before being produced is wholly immaterial.

The point involved is not the manner in which the agency is created but the effect of the tax. In the last analysis the test can not be more clearly stated than it was in Railroad v. Peniston, 85 U. S. (18 Wall.) 5, 36:

> "It is, therefore, manifest that exemption of Federal agencies from State taxation is dependent, *not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax;* that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power."

As stated in Ambrosini v. United States, 187 U. S. 1, "They are not mere individual undertakings to secure a personal privilege, as suggested by the court below" but means for the development of the State's resources for its own benefit.

The State granted these leases to obtain for itself a percentage of the gross proceeds of the oil produced, just as this Court said in reference to the Indian leases in Jaybird Mining Co. v. Weir, 271 U. S. 609, 614:

> "In this case the lease was made to secure the development of the lands and obtain for the benefit of the restricted Indian owners a percentage of the gross proceeds of the ores to be mined."

The fact that the lessees have derived an income from the leases is of no material consequence, for as was said in United States v. Railroad Company, 17 Wall. (84 U. S.) 322, 331:

> "It was not a loan for the benefit of the railroad; it was for the benefit of the city solely. That the railroad company was also benefited did not affect the purpose of the transaction."

As the State of Texas is entitled to have this petitioner free from all control by the United States, the taxes involved may not be sustained by simply calling the leases "sales" in the usual meaning of that term. The mere fact that the leases were interpreted as sales within the meaning of the Texas Constitution does not remove them from that class of instrumentalities that are exempt from Federal taxation. Just as the States may not justify an unconstitutional tax by applying to it a delusive name, so the United States may not tax an exempt subject by the use of an inapt characterization.

In Choctaw, Oklahoma & Gulf Railroad Company v. Harrison, 235 U. S. 292, 298, it is said:

> "Neither State courts nor legislatures by giving a tax *a particular name*, or by the use of some form of words, can take away our duty to consider its

real nature and effect. Galveston, Harrisburg & San Antonio R'y v. Texas, 210 U. S. 217, 227."

In Lacoste v. Department of Conservation, 263 U. S. 545, 550:

> "This court will determine for itself what is the necessary operation and effect of a State law challenged on the ground that it interferes with or burdens interstate commerce. *The name, description or characterization* given it by the legislature or the courts of the State will not necessarily control. Regard must be had to the substance of the measure rather than its form."

In Macallen Co. v. Massachusetts, 279 U. S. 620, 626:

> "If, by varying the form—that is to say, if, by using one *name* for a tax instead of another, or imposing a tax in terms upon one subject when another is in reality aimed at—the substance and effect of the imposition may be changed, constitutional limitations upon powers of taxation would come to naught."

In Mountain Timber Company v. Washington, 243 U. S. 219, 237:

> "The question whether a State law deprives a party of rights secured by the Federal Constitution depends *not upon how it is characterized*, but upon its practical operation and effect."

The necessity of freedom of action on the part of both State and Federal governments requires that the doctrine of the exemption of governmental instrumentalities be not narrowly applied.

In Jaybird Mining Company v. Weir, 271 U. S. 609, 613, it is said:

> "It is elementary that the Federal government in

all its activities is independent of State control. This rule is broadly applied."

In the recent case of Macallen Company v. Massachusetts, 279 U. S. 620, this Court, after discussing the principles of exemption of governmental instrumentalities, said at page 631:

> "A liberal application of the foregoing principles, which find confirmation especially in the later decisions of this court, is essential to the preservation of the constitutional limitations imposed upon the taxing power of the States. Let it once be conceded that such limitations may be evaded by the adoption of a delusive name to characterize the tax or form of words to describe it, and the destruction of the vitality of these necessary safeguards will soon follow."

This court has held exempt from State taxation varied forms of Federal instrumentalities. Patents on inventions, Long v. Rockwood, 277 U. S. 142; national banks, Owensboro National Bank v. Owensboro, 173 U. S. 664; Federal bonds and securities, Bank of Commerce v. New York City, 67 U. S. (2 Black) 620; Bank Tax Case, 69 U. S. (2 Wall.) 200; Home Savings Bank v. Des Moines, 205 U. S. 503; Miller v. Milwaukee, 272 U. S. 713; franchises to railroads, California v. Central Pacific R'y Co., 127 U. S. 1, and to telegraph companies, Telegraph Company v. Texas, 105 U. S. 460; Williams v. City of Talladega, 226 U. S. 404; sellers of gasoline to the Federal government, Panhandle Oil Company v. Knox, 277 U. S. 218, Graysburg Oil Company v. Texas, 278 U. S. 582. Petitioner is as important an agency of the State of Texas as any of these were of the United States.

We submit, therefore, that petitioner, as an agency of the State, is exempt from the Federal income taxes.

III.

By Section 27 of the 1917 Act the State of Texas did not grant permission to the United States to levy these income taxes upon its agencies, and no such taxes may be levied without the express consent of the State.

The Circuit Court of Appeals reversed the judgment of the District Court on the sole ground that by Section 27 of the 1917 Act, which reads "Rights acquired under this Act shall be subject to taxation as is other property," the State gave its consent to the levy of these taxes by the Federal government. That court said:

> "The State of Texas by throwing the leases on university lands open to taxation generally, withdrew from the lessees all rights of exemption which might otherwise have existed." (R. 49.)

The court apparently treated the taxation of petitioner as a matter in which the State had no concern, and as if by this so-called waiver the State waived no rights of its own but a mere private right of petitioner. It further apparently was under the impression that the State by some affirmative statute must declare these lessees to be exempt from Federal taxation. We call the attention of the court particularly to the following from that court's opinion:

> "It may be assumed without being decided that the State was entitled to claim exemption for itself, or even for appellee as its instrumentality, in developing the public domain. * * * The State of

> Texas has no occasion to claim immunity for itself, and has not sought to exempt lessees of its university lands from Federal income taxation." (R. 48.)

When the importance of the principles involved is considered, it is impossible to construe Section 27 as a waiver by the State of all the rights that would otherwise accrue to it. These principles are not embraced in any express provision of the Constitution, but, as this court said in M'Culloch v. Maryland, *supra:*

> "There is no express provision for the case, but the claim has been sustained on a principle which so entirely pervades the Constitution, is so intermixed with the materials which compose it, so interwoven with its web, so blended with its texture, as to be incapable of being separated from it without rending it into shreds."

If the Circuit Court of Appeals is correct, then the State of Texas has waived valuable constitutional rights of the State itself. It must always be remembered that this exemption of governmental agencies has been read into the Constitution for the protection of the State and Federal governments from encroachments by the one upon the exercise of the powers of the other. The individual welfare of the agency was not the reason for the origin of the rule. It was only because taxation of the agency tended to hinder it in the performance of its designated functions for the State that the rule was invoked. Therefore, to say that the State of Texas has waived the rights of its agency is to say that the State has waived its own rights. This was pointed out by the State in the brief it has heretofore filed in this case as *amicus curiae.*

This has been forcibly illustrated by the Supreme

Court of Texas in State v. Texas & Pacific Railway Co., 100 Texas 279, 283, in holding invalid a State occupation tax as to the railroad company whose charter was granted by the United States Congress for Federal purposes. In that case the court said:

> "The immunity is thus given to these so-called governmental agencies, *not as a private right of their own merely,* but as essential to the security of the rights of the government and the discharge of the duty which they are held to have assumed towards the government, which, it has been thought, would be unduly obstructed by a power in the States to impose taxes upon their operations. The power to tax, it has been said, is the power to destroy, and the existence of such a power in the States over the instrumentalities of the United States has always been regarded by the Supreme Court as inconsistent with the power of the Federal government to establish such agencies, and to provide for and enforce the efficient discharge of their duties to it. *It is the interest of the government, therefore, that controls, and not simply that of the agent.* If the right were recognized in such agencies by engagements with the States, to take on or throw off, at pleasure, the immunity deemed so essential to their efficiency, the great arguments by which, with such pains, the doctrine has been built up, would dwindle into insignificance."

If these lessees are exempt under the Constitution and under the compact between the United States and the Republic of Texas, their exemption need not be buttressed by any statutory declaration by the State to that effect. On the other hand, if they are not exempt under the Constitution and that compact, then no statute or other act of the State can grant them such exemption. Therefore, there is no necessity for the State to act affirmatively on the subject.

If these principles are of so vital importance to both the Federal and the State governments, neither will be held to have waived them unless such waiver is expressed in clear and unmistakable terms. This is the rule laid down by this Court in numerous cases.

> "Whether the property of one of the States of the Union is taxable under the laws of that State depends upon the intention of the State as manifested by those laws. But whether the property of the United States shall be taxed under the laws of a State depends upon the will of its owner, the United States, and *no State can tax the property of the United States without their consent.*" Van Brocklin v. Tennessee, 117 U. S. 151, 175.

> "It follows then necessarily from these conclusions that the respective States would be wholly without power to levy any tax, either direct or indirect, upon the national banks, their property, assets or franchises, *were it not for the permissive legislation of Congress.*" Owensboro National Bank v. Owensboro, 173 U. S. 664, 668.

> "It is elementary that the Federal government in all its activities is independent of State control. This rule is broadly applied. And, *without congressional consent*, no Federal agency or instrumentality can be taxed by State authority." Jaybird Mining Company v. Weir, 271 U. S. 609, 613.

In Bank of California v. Richardson, 248 U. S. 476, in speaking of the section of the United States Revised Statutes defining the taxes States might levy on national banks, this Court said at page 483:

> "There is also no doubt from the section that it was intended to comprehensively control the subject with which it dealt and thus to furnish the exclusive rule governing State taxation as to the Federal

agencies created as provided in the section. All possibility of dispute to the contrary is foreclosed by the decisions of this court."

Upon the same subject, in First National Bank v. Adams, 258 U. S. 362, this Court said at page 364:

> "Section 5219 Revised Statutes (copied below) prescribes the full measure of the power of the several States to impose taxes upon national banking associations or their stockholders. *Any assessment not in conformity therewith is unauthorized and invalid.*"

In Heiner v. Colonial Trust Company, 275 U. S. 232, this Court, in holding that Federal lessees of Indian lands, which it had previously held in the Oklahoma cases were exempt from State taxation, were subject to the Federal income tax, said on pages 234-235:

> "The power of the United States to tax the income is undoubted. It seems to us extravagant, in the face of the comprehensive language of the statute, to infer that Congress did not intend to exercise that power merely *because, in the absence of Congressional consent, it is one withheld from the States* or because the tax in terms imposed on others may have some economic effect upon the Indians themselves."

There is no reference whatever in Section 27 to Federal taxation. Direct taxes by the United States are the exception. In fact there have been no such direct ad valorem taxes on property since shortly after the Civil War.

In those instances where the Federal government has permitted States to tax its agencies, it has been careful to express such consent clearly. In permitting State taxation of mineral lessees of Federal lands, it stated:

> "Provided, that nothing in this Act shall be construed or held to affect the rights of the States or other local authority to exercise any rights which they may have, including the right to levy and collect taxes upon improvements, output of mines or other rights, property or assets of any lessee of the United States." Mid-Northern Oil Company v. Montana, 268 U. S. 45, 48.

In the case of national banks it has permitted certain classes of State taxes, but has in each case specified in detail exactly what taxes may be levied. Section 5219, United States Revised Statutes; United States Code, Title 12, Sec. 548. This Court has consistently stricken down all State taxes that did not come strictly within the permitted classes. In speaking of Sec. 5219, this Court said in Owensboro National Bank v. Owensboro, 173 U. S. 664, 669:

> "This section, then, of the Revised Statutes is the measure of power of a State to tax national banks, their property or their franchises. By its unambiguous provisions the power is confined to a taxation of the shares of stock in the names of the shareholders and to an assessment of the real estate of the bank. *Any State tax therefore which is in excess of and not in conformity to these requirements is void.*"

In removing the exemption of minerals on Indian lands from State taxation it uses clear and unambiguous terms:

> "All minerals, including oil and gas, produced on or after April 26, 1931, from restricted allotted lands of members of the Five Civilized Tribes in Oklahoma, or from inherited restricted lands of full-blood Indian heirs or devisees of such lands, shall be subject to all State and Federal taxes of every kind and character the same as those pro-

duced from lands owned by other citizens of the State of Oklahoma." 45 Stats. 495, Ch. 517, Sec. 3.

Attention is called to Title 12, Section 548, of the United States Code, which sets forth in minute detail the State taxes that may be levied on national banks. Any tax that does not come within its provisions is invalid.

Statutes relinquishing rights of a State are to be construed strictly in its favor. Although the bankruptcy laws contain broad provisions concerning the discharge of a bankrupt from his liabilities, nevertheless, debts owing to the United States are not discharged as they are not specifically mentioned in the law. United States v. Herron, 20 Wall. (87 U. S.) 251, in which this Court said that the question depended upon the provisions of the Bankrupt Act

> "when properly construed, in view of the settled rule of construction that the sovereign authority of the country is not bound by the words of a statute unless named therein, if the statute tends to restrain or diminish the powers, rights, or interests of the sovereign."

The government is not barred by statutes of limitation, Grand Trunk Western Railway Company v. United States, 252 U. S. 112; Davis v. Corona Oil Company, 265 U. S. 219; nor may it be sued without its express consent, Hill v. United States, 149 U. S. 593. Further illustrations might be furnished indefinitely.

That Section 27 was intended to apply only to State taxation becomes even more apparent when the circumstances surrounding its passage and the end sought by the legislature are considered. It is elementary that a statute will be construed in the light of contemporaneous

events and the situation confronting the legislature when it was passed and the object sought to be accomplished thereby.

> "Again, another guide to the meaning of a statute is found in the evil which it is designed to remedy; and for this the court properly looks at contemporaneous events, the situation as it existed, and as it was pressed upon the attention of the legislative body." Church of the Holy Trinity v. United States, 143 U. S. 457, 463.

> "But courts, in construing a statute, may with propriety recur to the history of the times when it was passed; and this is frequently necessary, in order to ascertain the reason as well as the meaning of particular provisions in it. Aldridge v. Williams, 3 How. 24; Preston v. Browder, 1 Wheat. 120." United States v. Union Pacific Railroad Company, 91 U. S. 72, 79.

Statutes will always be construed to give effect to the intention of the legislature, and the strict letter of a statute yields to the evident spirit and purpose of the enactment.

> "It thus becomes our duty to endeavor to ascertain what the intention of Congress really was, and in the construction of a statute and in ascertaining its true meaning and application resort may be had not only to the language of the statute, but also to the intention of the legislature. The rule is fundamental that in construing statutes the court should ascertain and give effect to the intention of the legislature." United States v. Tod, 285 Fed. 847, 851.

> "The strict letter of an act must, however, yield to its evident spirit and purpose, when this is necessary to give effect to the intent of Congress." Fleischmann Company v. United States, 270 U. S. 349, 360.

As heretofore pointed out, the first act providing for mineral leases on State lands was that of April 9, 1913 (Laws of 1913, Ch. 173, p. 409, 33rd Leg.), which was repealed and superseded by that of 1917. In the 1913 Act, Section 28 provided:

> "The rights acquired under this act shall be subject to taxation as is other property after the owner shall have paid to the State the sums necessary to perfect his rights."

Section 27 of the 1917 act merely carried this forward in the following language:

> "Rights acquired under this act shall be subject to taxation as is other property."

The immediate cause for the insertion of this provision in the 1913 act was the fact that, when that act was being considered, the State taxing authorities were being forced to litigate the point of whether the interest of an oil and gas lessee was property subject to taxation within the definition of taxable property under the general laws. This litigation is reported in Texas Company v. Daugherty, 160 S. W. 129 (Court of Civil Appeals), 107 Tex. 226 (Supreme Court). When the 1913 act was passed on April 9, 1913, that case was pending in the Court of Civil Appeals, not being decided by that court until July 5, 1913, or by the Supreme Court until May 21, 1915.

At that time and for several years afterward the exact nature of the interest of an oil and gas lessee in the leased premises was very unsettled in Texas. Some contended that, as oil and gas were fugitive substances, the lessor himself had no title to them while in place,

and therefore a lease conveyed to the lessee no title or estate in the land or in the oil but only the right to explore and, if discovered, sever the oil from the land when produced. This is illustrated by the following extracts from the argument of The Texas Company at pages 226-7 of 107 Texas:

> "By their very nature oil and gas are fugitive substances, and the owner of the land having a fee title thereto, has nevertheless no title to the oil and gas in site. * * * Oil and gas do not become private property until reduced to actual possession by one who has that right, and then by the severance of the same it becomes personal property and is not real property. * * * An oil and gas lease, from the very nature of the subject matter, conveys to lessee or grantee no title to estate in the land or in the oil or gas thereunder, but only the right to explore and, if discovered, sever the oil and gas from said land. * * * Each oil and gas lease under review in this suit is a franchise or the grant of a right and privilege to enter upon, explore and produce oil and gas, and is a chattel real. * * * A chattel real or a privilege growing out of real estate, though of ascertainable value, is not subject to taxation unless made so by some legislative act."

It therefore contended that it as lessee had no interest in land or real estate that was taxable under Article 7504, R. S. 1911, defining property subject to taxation as follows:

> "Real property, for the purpose of taxation, shall be construed to include the land itself, whether laid out in town lots or otherwise, and all buildings, structures and improvements, or other fixtures of whatsoever kind thereon, and all the rights and privileges belonging or in anywise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same."

The legislature was faced with the possibility of the Supreme Court's holding that such leases were not subject to taxation. To remove any danger of this as to leases it proposed to authorize on the State's lands, it expressly provided by Section 28 of the 1913 act that those leases should be taxable. This was the one thought and end the legislature had in view, and to hold that the word "taxation" included Federal taxes is to read into the section a meaning that the legislature never intended.

This is further illustrated by the contemporaneous House Bill No. 812 introduced in the legislature on March 8, 1913. (The journal of the Texas legislature seldom prints bills that are introduced and does not give any report of legislative debates or proceedings before committees. We have therefore had placed in the Record at page 44 a copy of this bill and the committee report, certified by the Secretary of State of Texas, the official custodian of the originals. A copy is inserted in the Appendix to this brief at page 124.) This proposed to amend Article 7504, *supra*, by adding the following:

> "also all leasehold interests whereby the lessee, grantee or licensee is authorized to mine and prospect for and take from lands, stone, granite, marble, fossils, minerals of any kind, including oil and gas."

The end sought was set forth in the emergency clause:

> "Sec. 2. The fact that the right of the State to tax leasehold interests in lands under which the lessee, grantee or licensee is permitted to prospect for and mine or take from said lands minerals, including oil and gas, is being disputed by the owners

of said leasehold interests, and the State is being forced to have litigation with such persons, therefore the necessity to render the law of this State upon said subject beyond cavil or the possibility of a doubt, creates an emergency, etc."

It is clear, therefore, the purpose of Section 28 of the 1913 act was simply to insure beyond cavil or the possibility of a doubt, that the State's lessees would pay State taxes on their leases.

As above stated, Texas Company v. Daugherty was not decided by the Court of Civil Appeals until July 5, 1913, and by the Supreme Court until May 21, 1915. Even then the question was still unsettled, and it was not until the decision on June 30, 1923, in Stephens County v. Mid-Kansas Oil & Gas Company, 113 Tex. 160, that the Supreme Court definitely held that, regardless of the granting clause of a lease, whether it is "grant, bargain, sell and convey," as in the Texas Company case, or "let and lease," as in the Stephens County case, or in any other words, the lessee's leasehold interest is a taxable estate in real property. As the law was still in this unsettled condition when the 1917 Leasing Act was passed, this Section 28 was carried forward as Section 27 to insure that the leases would be subject to State taxes. When it became finally settled by the Stephens County case in 1923 that oil and gas leases were subject to taxation under the general law, this provision was entirely omitted from the Leasing Acts of 1925 and 1929. This later action of the legislature clearly shows it had in mind only State taxation when it inserted Sections 28 and 27, respectively, in the 1913 and 1917 acts. When the end sought by the legislature in enacting those sections had been fully

attained by the decisions in Texas Company v. Daugherty and Stephens County v. Mid-Kansas Oil & Gas Company, it dropped them from the Leasing Acts.

An echo from this prior litigation was heard in this Court in Waggoner Estate v. Wichita County, 273 U. S. 113, in which this Court held that a royalty interest was an interest in real property and taxable in the county where the land was situated, and was not personal property taxable in the county of the taxpayer's domicile.

Even though it might possibly be said that Federal taxation was included in the term "taxation" as used in Section 27, nevertheless as Federal taxation was not within the intention of the legislature, it will not be included within the general term of taxation as used in that section.

> "First, it has been repeatedly decided that 'a thing which is in the letter of a statute is not within the statute unless it be within the intention of the makers.' Dwarris on Statutes, 692; Dac. Abr. Statute, T; 2 Instit. 107, 386." Wilson v. Rousseau, 4 How. 646, 694.

> "It may be admitted that an admiralty case is a civil suit in the general sense of that phrase. But that is not the question before us. It is whether that is the meaning of the phrase as used in this section. The intention of the lawmaker constitutes the law. A thing may be within the letter of a statute and not within its meaning, or within its meaning though not within its letter." Atkins v. The Disintegrating Company, 18 Wall. (85 U. S.), 272, 301.

> "'A thing which is within the letter of the statute is not within the statute, unless it be within the intention of the makers.' 1 Bac. Abr. 247." Leav-

enworth, Lawrence, and Galveston Railroad Company v. United States, 92 U. S. 733, 742.

"The intention of the law-maker constitutes the law: a thing may be within the letter of a statute, and not within its meaning; and within its meaning, though not within its terms." Indianapolis and St. Louis Railroad Company v. Horst, 93 U. S. 291, 300.

"It is a universal rule in the exposition of statutes that the intent of the law, if it can be clearly ascertained, shall prevail over the letter, and this is especially true where the precise words, if construed in their ordinary sense, would lead to manifest injustice." Lionberger v. Rouse, 9 Wall., 76 U. S. 468, 475.

"It is undoubtedly the duty of the court to ascertain the meaning of the legislature, from the words used in the statute, and the subject matter to which it relates; and to restrain its operation within narrower limits than its words import, if the court are satisfied that the literal meaning of its language would extend to cases which the legislature never designed to embrace in it." The Lessee of Brewer v. Blougher, 14 Peters 178, 198.

It is apparent that Section 27 did not refer to taxation by the United States, not only from the fact that Federal taxation is not expressly mentioned in Section 27, but from the circumstances surrounding its original incorporation as Section 28 in the Act of 1913, and the fact that, after the Supreme Court of Texas had settled the proposition that oil leases were taxable as property, this section was omitted in the 1925 and 1929 Leasing Acts. Even though Federal taxation might be included in the term "taxation" if construed broadly, neverthe-

less it will not be so construed where it was evidently not the purpose of the legislature to deal with Federal taxation, and even though Federal taxes might be within the letter, it will not be included within the statute as it was not within the intention of the legislature. To construe this section otherwise would extend it to a class of taxes that the legislature never designed to embrace within it. Such construction would furthermore be inequitable and unjust to lessees under the 1917 act as compared to lessees under the 1925 and 1929 acts, as the latter would not be subject to Federal taxes as their acts do not include Section 27.

The Circuit Court of Appeals based its construction of Section 27 on Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575, stating that Section 27 was no broader than the provision in that case subjecting Indian lands to State taxation. For comparison we set the two sections out as follows:

SECTION 27 OF TEXAS ACT.	SECTION 4 OF FEDERAL ACT.
"Rights acquired under this act shall be subject to taxation as is other property."	"All land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes."

The opinion of this Court in that case reviews the circumstances surrounding its passage and points out that Congress intended this Section 4 to relate to State taxation as part of an established program of gradually

converting the Indians into an independent and self-reliant people by granting them the priviliges of citizens and at the same time developing their sense of responsibility by placing on them the burdens of citizenship. As this Court said in that opinion:

> "In this (that is, the Act of 1908), as in other Indian legislation, opportunity is afforded for their emancipation by imposing upon them duties as well as giving them the privileges of citizens and property owners, including the duty to pay taxes." (Page 580.)
>
> "To hold them immune would be inconsistent with one of the very purposes of their creation, to educate the Indians in responsibility, and would present the curious paradox that the Secretary by a mere conveyancer's restriction, permitted by Congress, had rendered the land free from taxation and thus actually relieved the Indians of all responsibility."

Furthermore, the provision of Section 4 was inserted at the request of Oklahoma for the specific purpose of allowing it to tax these lands, as was pointed out at page 581:

> "This section was adopted in response to representations that the revenue of the State of Oklahoma was insufficient for State purposes, that large areas of lands within the State allotted to Indians were exempt from taxation as agencies of the Federal Government and that Indian citizens were enjoying the benefit of local government without taxation."

The end sought by Congress in enacting Section 4 was to make these Indian lands expressly subject to State taxation. The end sought by Texas in enacting Section 27 was to insure the leases being subject to taxation by the State and its subdivisions with no thought

as to Federal taxation. Therefore that case does not support the Circuit Court of Appeals in its construction of Section 27.

The mere fact that the leases are subject to State taxation does not take away their exemption from Federal taxation. The Texas statutes, Article 7147, R. S. 1925, provide that "bonds" and "all public stock and securities" shall be subject to taxation, but the Federal government may not tax the income therefrom. Pollock v. Farmers Loan & Trust Company, 157 U. S. 429. The Federal income tax law applies to Federal employees, but this does not allow a State to tax them.

If the Circuit Court of Appeals were correct, this anomalous result would follow: If three lessees held leases on three adjoining tracts of University land, one under the 1917 act, one under the 1925 Act and the other under the 1929 Act, the 1917 lessee would pay the Federal taxes but the other two would not, as their acts do not contain Section 27 of the 1917 act. It is upon that section the Circuit Court of Appeals sustained these taxes. The legislature never intended such an unequal burden of taxation to be placed on the State's lessees.

It is submitted, therefore, that Section 27 referred solely to taxation by the State of Texas and its subdivisions, and the Circuit Court of Appeals erred in construing it as authorizing the collection of these Federal income taxes.

IV.

Section 27 of the 1917 Act was repealed as to these leases on March 10, 1925, before the taxes involved in this cause were levied or became due and payable.

The first taxes sued for were paid for the fiscal year ending June 30, 1925. (R. 2-3.) The income tax return for that year was not due to be filed until September 15, 1925. Section 227 (a) of the Revenue Acts of 1924 and 1926. The 1925 Leasing Act was approved and became effective on March 10, 1925.

The 1917 act dealt with University lands and all other lands of the State. The 1925 act dealt solely with University lands and as to such lands repealed the 1917 act. Theisen v. Robison, 117 Tex. 489, 512. As the taxability of oil leases had been settled in 1923 in Stephens County v. Mid-Kansas Oil & Gas Co., *supra*, there was no necessity for carrying forward Section 27. Accordingly neither the 1925 Act nor that of 1929 contained such a clause.

It is well settled that, where a statute covers the entire subject-matter involved in a prior statute, the later statute repeals the former. This rule is so well established that authorities need hardly be cited.

In Tracy v. Tuffly, 134 U. S. 206, the court said at page 223:

> "And while it is true that repeals by implication are not favored by the courts, it is settled that, without express words of repeal, a previous statute will be held to be modified by a subsequent one, if the latter was plainly intended to cover the whole subject embraced by both, and to prescribe the only rules in respect to that subject that are to govern. United States v. Tynen, 11 Wall. 88, 95; Cook County National Bank v. United States, 107 U. S. 445, 451."

See also King v. Cornell, 106 U. S. 395; The Paquete Habana, 175 U. S. 677, 685.

In St. Louis & Southwestern Railway Company v. J. A. Kay Company, 85 Tex. 558, the court said at page 560:

> "In Rogers v. Watrous (8 Tex. 62), *supra*, Judge Wheeler says: 'A subsequent statute revising the subject matter of a former one, and evidently intended as a substitute for it, although it contains no express words to that effect, must operate to repeal the former to the extent to which its provisions are revised and supplied. So, though a subsequent statute be not repugnant in its provisions to a former one, yet if it was clearly intended to prescribe the only rules which should govern, it repeals the prior statute.' "

The 1925 act covered the entire subject of oil and gas leases on University lands, and thereafter all such leases were granted subject to its provisions and not those of the 1917 act. It is true such repeal could not affect the rights granted by the State to lessees under prior acts, and the 1925 act did not attempt to cancel such leases. However, it did repeal the provision of Section 27 dealing with taxation. There was no reason for a special provision like Section 27 to remain applicable to 1917 leases for State taxation purposes, while 1925 leases were subject to State taxes only under the general taxing laws.

Furthermore, as heretofore pointed out, if Section 27 has the effect attributed to it by the Circuit Court of Appeals, lessees holding under the 1917 act would be subject to the Federal income taxes while those under the 1925 and 1929 acts would not. The legislature never intended such a manifestly unequal burden of taxation to result. It would be contrary to the general policy of all governments that taxes shall be equal and uniform,

and would violate the express provision of Article VIII, Section 1, of the Texas Constitution, that

"Taxation shall be equal and uniform."

Even if Section 27 could possibly be construed as a grant by the State of permission to the Federal government to tax its lessees, the legislature clearly evidenced its intention to withdraw such permission by entirely omitting it in the 1925 and 1929 acts.

As Section 27 was repealed as to leases on University lands on March 10, 1925, it was not in effect during the time for which these taxes were levied, and the court in sustaining these taxes under Section 27 was in error.

Conclusion.

The constitutional exemption claimed by petitioner has been recognized in innumerable decisions of this Court since M'Culloch v. Maryland. It has been particularly emphasized in recent years. In addition to the cases involving lessees of Indian lands, this Court has invoked the principle in striking down State taxes and regulations in Johnson v. Maryland, 254 U. S. 51, First National Bank v. Adams, 258 U. S. 362, First National Bank v. California, 262 U. S. 366, Childers v. Beaver, 270 U. S. 555, Miller v. Milwaukee, 272 U. S. 713, Northwestern Mutual Life Insurance Company v. Wisconsin, 275 U. S. 136, Long v. Rockwood, 277 U. S. 142, Panhandle Oil Company v. Knox, 277 U. S. 218, and Graysburg Oil Company v. Texas, 278 U. S. 582, and a provision of the United States Revenue Act of 1921 in National Life Insurance Company v. United States, 277 U. S. 508. This Court particularly stressed the imperative necessity of

this constitutional principle in The Macallen Company v. Massachusetts, 279 U. S. 620. It has become such an integral part of the Constitution that it cannot be changed except by an amendment to the Constitution itself.

We submit that this case is in principle identical with that of Gillespie v. Oklahoma, 257 U. S. 501, and that the words of this Court in that case

> "'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon income from the leases is not long,"

are strictly applicable to the leases of petitioner and its income therefrom.

It is respectfully prayed that the judgment of the Circuit Court of Appeals be reversed and that of the District Court affirmed.

HOMER L. BRUCE,
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APPENDIX A

Resolutions Resulting in Annexation of Texas.

The following is a copy of the joint resolution of the Congress of the United States, 5 Stats. 797:

No. 8. Joint Resolution for annexing Texas to the United States.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That Congress doth consent that the territory properly included within, and rightfully belonging to the Republic of Texas, may be erected into a new State, to be called the State of Texas, with a republican form of government, to be adopted by the people of said Republic, by deputies in convention assembled, with the consent of the existing government, in order that the same may be admitted as one of the States of this Union.

2. And be it further resolved, That *the foregoing consent of Congress is given upon the following conditions, and with the following guarantees,* to wit: First, Said State to be formed, subject to the adjustment by this government of all questions of boundary that may arise with other governments; and the Constitution thereof, with the proper evidence of its adoption by the people of said Republic of Texas, shall be transmitted to the President of the United States, to be laid before Congress for its final action, on or before the first day of January, one thousand eight hundred and forty-six. Second: *Said State,* when admitted into the Union, after ceding to the United States, all public edifices, fortifications, barracks, ports and harbors, navy and navy-yards, docks, magazines, arms, arm-

aments, and all other property and means pertaining to the public defense belonging to said Republic of Texas, shall retain all the public funds, debts, taxes, and dues of every kind, which may belong to or be due and owing said republic; and *shall also retain all the vacant and unappropriated lands lying within its limits, to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after discharging said debts and liabilities, to be disposed of as said State may direct;* but in no event are said debts and liabilities to become a charge upon the Government of the United States. Third, New States, of convenient size, not exceeding four in number, in addition to said State of Texas, and having sufficient population, may hereafter, by the consent of said State, be formed out of the territory thereof, which shall be entitled to admission under the provisions of the Federal Constitution. And such States as may be formed out of that portion of said territory lying south of thirty-six degrees thirty minutes north latitude, commonly known as the Missouri compromise line, shall be admitted into the Union with or without slavery, as the people of each State asking admission may desire. And in such State or States as shall be formed out of said territory north of said Missouri compromise line, slavery, or involuntary servitude (except for crime), shall be prohibited.

3. And be it further resolved, That if the President of the United States shall in his judgment and discretion deem it most advisable, instead of proceeding to submit the foregoing resolution to the Republic of Texas, as an overture on the part of the United States for admission, to negotiate with that Republic; then,

Be it resolved, That a State, to be formed out of the present Republic of Texas, with suitable extent and boundaries, and with two representatives in Congress, until the next apportionment of representation, shall be admitted into the Union, by virtue of this act, on an equal footing with the existing States, as soon as the terms and conditions of such admission, and the cession of the remaining Texian territory to the United States shall be agreed upon by the Governments of Texas and the United States: And that the sum of one hundred thousand dollars be, and the same is hereby, appropriated to defray the expenses of missions and negotiations, to agree upon the terms of said admission and cession, either by treaty to be submitted to the Senate, or by articles to be submitted to the two houses of Congress, as the President may direct.

APPROVED, March 1, 1845.

* * * * * * *

After the adoption of this resolution, the Congress of the Republic of Texas adopted the following resolution set forth in 2 Gammel's Laws of Texas, page 1200.

Joint Resolution.

Giving the consent of the existing Government to the annexation of Texas to the United States.

Whereas, the Government of the United States hath proposed the following terms, guarantees, and conditions, on which the People and Territory of the Republic of Texas may be erected into a new State, to be called the State of Texas, and admitted as one of the States of the American Union, to wit:

"Resolved by the Senate and House of Representatives of the United States of America in Congress as-

sembled, That Congress doth consent that the Territory properly included within and rightfully belonging to the Republic of Texas may be erected into a new State, to be called the State of Texas, with a Republican form of Government, to be adopted by the people of said Republic, by deputies in Convention assembled, with the consent of the existing Government, in order that the same may be admitted as one of the States of this Union.

"2. And be it further resolved, That the foregoing consent of Congress is given upon the following conditions, and with the following guarantees, to wit:

"First. Said State to be formed subject to the adjustment by this Government of all questions of boundary that may arise with other Governments, and the Constitution thereof, with the proper evidence of its adoption, by the people of said Republic of Texas, shall be transmitted to the President of the United States, to be laid before Congress for its final action, on or before the first day of January, one thousand eight hundred and forty-six.

"Second. Said State when admitted into the Union after ceding to the United States all public edifices, fortifications, barracks, ports and harbors, navy and navy-yards, docks, magazines, arms, armaments and all other property and means pertaining to the public defence, belonging to the said Republic of Texas, shall retain all the public funds, debts, taxes, and dues of every kind which may belong to or be due and owing said Republic; and shall also retain all the vacant and unappropriated lands lying within its limits, to be applied to the payment of the debts and liabilities of said Republic of Texas, and the residue of said lands, after

discharging said debts and liabilities, to be disposed of as said State may direct; but in no event are said debts and liabilities to become a charge upon the Government of the United States.

"THIRD. New States of convenient size, not exceeding four in number, in addition to said State of Texas, and having sufficient population, may hereafter, by the consent of said State, be formed out of the territory thereof, which shall be entitled to admission under the provisions of the Federal Constitution. And such States lying south of thirty-six degrees thirty minutes north latitude, commonly known as the Missouri compromise line, shall be admitted into the Union, with or without slavery, as the people of each State asking admission may desire. And in such State or States as shall be formed out of said territory north of said Missouri compromise line, slavery or involuntary servitude except for crime shall be prohibited."

And whereas, by said terms, the consent of the existing government of Texas is required—Therefore,

Be it resolved by the Senate and House of Representatives of the Republic of Texas, in Congress assembled, That the Government of Texas doth consent, that the People and Territory of the Republic of Texas, may be erected into a new State, to be called the State of Texas, with a Republican form of Government, to be adopted by the people of said Republic, by Deputies in Convention assembled, in order that the same may be admitted as one of the States of the American Union, and *said consent is given on the terms, guarantees and conditions set forth in the Preamble to this Joint Resolution.*

SEC. 2. Be it further resolved, That, the Proclama-

tion of the President of the Republic of Texas, bearing date May fifth, eighteen hundred and forty-five, and the election of Deputies to set in Convention, at Austin on the fourth day of July next for the adoption of a Constitution for the State of Texas, had in accordance therewith, hereby receives the consent of the existing Government of Texas.

SEC. 3. Be it further resolved, That, the President of Texas is hereby requested immediately to furnish the Government of the United States, through their accredited Minister near this Government, with a copy of this Joint Resolution; also to furnish the Convention to assemble at Austin, on the fourth of July next, a copy of the same—And the same shall take effect from and after its passage.

JOHN M. LEWIS,
Speaker of the House of Representatives
K. L. ANDERSON,
President of the Senate.

Approved, June 23, 1845.

ANSON JONES.

Thereafter the Convention of the People of the Republic of Texas adopted a similar resolution on July 4, 1845. This resolution is practically identical with the foregoing and is not here copied. It may be found in 2 Gammel's Laws of Texas, page 1228.

* * * * * * *

After these resolutions had been adopted, the Congress of the United States adopted the following resolution formally admitting Texas into the Union, which resolution is set forth in 9 United States Statutes at Large, page 108.

(No. 1.)—Joint Resolution for the Admission of the State of Texas into the Union.

Whereas the Congress of the United States, by a joint resolution approved March the first, eighteen hundred and forty-five, did consent that the territory properly included within, and rightfuly belonging to, the Republic of Texas, might be erected into a new State, to be called THE STATE OF TEXAS, with a republican form of government, to be adopted by the people of said republic, by deputies in convention assembled, with the consent of the existing government, in order that the same might be admitted as one of the States of the Union; which consent of Congress was given upon certain conditions specified in the first and second sections of said joint resolution; and whereas the people of the said Republic of Texas, by deputies in convention assembled, with the consent of the existing government, did adopt a Constitution, and erect a new State with a republican form of government, and, in the name of the people of Texas, and by their authority, did ordain and declare that they assented to and accepted the proposals, conditions, and guaranties contained in said first and second sections of said resolution; and whereas the said Constitution, with the proper evidence of its adoption by the people of the Republic of Texas, has been transmitted to the President of the United States and laid before Congress, in conformity to the provisions of said joint resolution:

Therefore—

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the State of Texas shall be one, and is hereby declared to be one, of the United States of America,

and admitted into the Union on an equal footing with the original States in all respects whatever.

SECTION 2. And be it further resolved, That until the representatives in Congress shall be apportioned according to an actual enumeration of the inhabitants of the United States, the State of Texas shall be entitled to choose two representatives.

APPROVED December 29, 1845.

APPENDIX B

Sections 10, 11, 12, 13, 14 and 15 of Article VII of the Constitution of the State of Texas, Pertaining to the University of Texas.

SEC. 10. The legislature shall, as soon as practicable, establish, organize and provide for the maintenance, support and direction of a university of the first class, to be located by a vote of the people of this State, and styled, "The University of Texas," for the promotion of literature, and the arts and sciences, including an agricultural and mechanical department.

SEC. 11. In order to enable the legislature to perform the duties set forth in the foregoing section, it is hereby declared that all lands and other property heretofore set apart and appropriated for the establishment and maintenance of the University of Texas, together with all the proceeds of sales of the same, heretofore made or hereafter to be made, and all grants, donations and appropriations that may hereafter be made by the State of Texas, or from any other source, shall constitute and become a permanent university fund. And the same as realized and received into the treasury of the State (together with such sum belonging to the fund, as may now be in the treasury), shall be invested in bonds of the State of Texas, if the same can be obtained; if not, then in United States bonds; and the interest accruing thereon shall be subject to appropriation by the legislature to accomplish the purpose declared in the foregoing section; provided, that the one-tenth of the alternate sections of the lands granted to railroads, reserved by the State which were set apart and appropriated to the establishment of the

University of Texas, by an Act of the Legislature of February 11, 1858, entitled "An Act to establish 'the University of Texas'," shall not be included in, or constitute a part of, the permanent university fund.

SEC. 12. The land herein set apart to the university fund shall be sold under such regulations, at such times, and on such terms as may be provided by law; and the legislature shall provide for the prompt collection, at maturity, of all debts due on account of university lands heretofore sold, or that may hereafter be sold, and shall in neither event have the power to grant relief to the purchasers.

SEC. 13. The Agricultural and Mechanical College of Texas, established by an Act of the Legislature, passed April 17, 1871, located in the County of Brazos, is hereby made and constituted a branch of the University of Texas, for instruction in agriculture, the mechanic arts, and the natural sciences connected therewith. And the legislature shall, at its next session, make an appropriation, not to exceed forty thousand dollars, for the construction and completion of the buildings and improvements and for providing the furniture necessary to put said college in immediate and successful operation.

SEC. 14. The legislature shall, also, when deemed practicable, establish and provide for the maintenance of a college or branch university for the instruction of the colored youths of the State, to be located by a vote of the people; provided, that no tax shall be levied, and no money appropriated out of the general revenue, either for this purpose or for the establishment and erection of the buildings of the University of Texas.

SEC. 15. In addition to the lands heretofore granted

to the University of Texas, there is hereby set apart and appropriated for the endowment, maintenance, and support of said university and its branches, one million acres of the unappropriated public domain of the State; to be designated and surveyed as may be provided by law; and said lands shall be sold under the same regulations, and the proceeds invested in the same manner, as is provided for the sale and investment of the permanent university fund, and the legislature shall not have the power to grant any relief to the purchasers of said lands.

APPENDIX C

Act of March 16, 1917—35th Legislature, P. 158.

Chapter 83.

An Act to Amend Chapter 173 of the Regular Session of the Thirty-third Legislature approved April 9, 1913, relating to the prospecting for and the development of the minerals and other substances in the public land, public islands and public waters and river beds and channels owned by the State, and in the unsold land belonging to the public free school fund, the University fund and the several asylums fund and in such of said land as has heretofore been sold or may hereafter be sold with the reservation of the minerals and other substances therein to the fund to which the land belongs; providing the royalty and other sums and compensation to be paid to the State and owners of the surface, and appropriating the proceeds to certain funds; providing for ingress and egress; providing one may pay cash for mineral claims, and obtain patents and change former claims to rights under this Act; providing for the adoption of rules and regulations by the Commissioner of the General Land Office, repealing the remaining portion of this said Chapter 173 which may not be amended and all other statutes in conflict with this Act, and declaring an emergency.

Be It Enacted By the Legislature of the State of Texas:

SECTION 1. All of Chapter 173 of the Regular Session of the Thirty-third Legislature approved April 9, 1913, shall be so amended as to hereafter read as follows:

SECTION 1. All public school, University and Asylum land and other public lands, fresh water lakes, river beds and channels, islands, bays, marshes, reefs and salt water lakes belonging to the State and all lands which may hereafter be so owned and all of said lands which have heretofore been sold or disposed of

by the State or by its authority with a reservation of minerals or mineral rights therein as well as all lands which may hereafter be sold with the reservation of minerals or mineral rights therein, and lands purchased with a relinquishment of the minerals therein, shall be included within the provisions of this Act and shall be open to the prospecting for and the development of the minerals and substances known as gold, silver, cinnebar, lead, tin, copper, zinc, platinum, radio-active minerals, tungsten, ores of aluminum, coal, lignite, iron ore, kaolin fire clays, barite, marble, petroleum, natural gas, gypsum, nitrates, asbestos, marls, salt, onyx, turquoise, mica, guano, bismuth and bismuth bearing minerals, asphalt, potash compounds, sulphur, graphite, magnesia, fuller's earth, molybdenum and molybdenum bearing minerals upon the terms and conditions provided in this Act.

SECTION 2. Any person or association of persons, corporate or otherwise, being a citizen of the United States or having declared an intention of becoming such, desiring to obtain the right to prospect for and develop the minerals and substances named above that may be in any of the areas included herein may do so under the provisions of this Act together with such rules and regulations as may be adopted by the Commissioner of the General Land Office relative thereto and necessary for the execution of the purposes of this Act.

SECTION 3. One desiring to obtain the right to prospect for and develop petroleum oil and natural gas that may be in any of the surveyed areas included herein shall file with the County Clerk an application in writing giving a designation of same sufficient to identify it. The county clerk shall, upon receipt of

one dollar as a filing fee, file and record the application and note the same on his record of surveys opposite the entry of the proper survey, giving the time of filing. When one has obtained four sections or that equivalent eligible to be embraced in one permit such applicant shall not obtain any more land within two miles thereof, but if one obtains less than four sections eligible to be embraced in one permit such one may obtain such additional area within two miles of the other area as will equal four sections. One shall not obtain more than one thousand acres within one mile of a well producing petroleum.

SECTION 4. One desiring to obtain the right to prospect for and develop petroleum and natural gas in any of the State's unsurveyed areas named in this Act shall file with the county surveyor an application in writing for each area applied for, giving a designation of same sufficient to identify it, but such area shall not exceed 2560 acres. Upon receipt of one dollar filing fee the surveyor shall file and record the application.

SECTION 5. When the Commissioner receives an application that was filed with the County Clerk or an application that was filed with the surveyor and the field notes and plat, one dollar filing fee and ten cents per acre for each acre applied for and a sworn statement by the applicant showing what interest he has in other permit, lease or patent issued under this Act and in good standing, he shall file same, and if upon examination the application or the application and field notes are found correct and the area applied for is within the provisions of this Act the Commission shall issue to the applicant or his assignee a permit conferring upon him an exclusive right to prospect for and develop

petroleum and natural gas within the designated area for a term not to exceed two years.

SECTION 6. Before the expiration of six months after the date of the permit the owner thereof shall in good faith begin actual work necessary to the physical development of said area and if petroleum or natural gas is not sooner developed in commercial quantities the owner or manager shall, within thirty days after the expiration of one year from the date of the permit, file in the General Land Office a sworn statement supported by two disinterested credible persons that such actual work was begun within the first six months aforesaid and that a bona fide effort to develop the said area was made during the six months preceding the filing of the statement and showing what work was done and expenditures incurred and whether or not petroleum or natural gas had been discovered in commercial quantities. A failure to file the statement herein provided for within the time specified or the filing of a statement untrue or false in material matters shall subject the permit to forfeiture and the termination of the rights of the owner. The owner of a permit shall not take, carry away or sell any petroleum or natural gas before obtaining a lease therefor; provided, such quantity as may be necessary for the continued development of the area before obtaining a lease may be used without accounting therefor.

SECTION 7. If at any time within the life of a permit one should develop petroleum or natural gas in commercial quantities the owner or manager shall file in the General Land Office a statement of such development within thirty days thereafter, and thereupon the owner of the permit shall have the right to lease the

area included in the permit upon the following conditions:

1. An application and a first payment of two dollars per acre for a lease of the area included in the permit shall be made to the Commissioner of the General Land Office within thirty days after the discovery of petroleum or natural gas in commercial quantities.

2. Upon the payment of two dollars per acre for each acre in the permit a lease shall be issued for a term of ten years or less, as may be desired by the applicant, and with the option of a renewal or renewals for an equal or shorter period, and annually after the expiration of the first year after the date of the lease the sum of two dollars per acre shall be paid during the life of the lease, and in addition thereto the owner of the lease shall pay a sum of money equal to a royalty of one-eighth of the value of the gross production of petroleum. The owner of a gas well shall pay a royalty of one-tenth of the value of the meter output of all gas disposed of off the premises.

3. The royalties shall be paid to the State through the Commissioner of the General Land Office at Austin, monthly during the life of the lease. All payments shall be accompanied by the sworn statement of the owner or manager or other authorized agent showing the amount produced since the last report and the market value of the output and a copy of all pipe line receipts, tank receipts, gauge of all tanks into which petroleum may have been run, or other checks and memoranda of amount put out or into pipe lines or tanks or pools. The books and accounts, the receipts and discharges of all pipe lines, tanks and pools and gas lines and gas pipes and all other matters pertain-

ing to the production, transportation and marketing of the output shall be open to the examination and inspection at all times by the Commissioner of the General Land Office or his representative or any other person authorized by the Governor or Attorney General to represent the State. The value of any unpaid royalty and any sum due the State under this Act upon any lease shall become as prior lien upon all production produced upon the leased areas and the improvements situated thereon to secure the payment of any royalty and any sum due the State arising under the operation of any portion of this Act.

4. The permit or lease shall contain the terms upon which it is issued including the authority of the Commissioner to require the drilling of wells necessary to offset wells drilled upon adjacent private land, and such other matters as the Commissioner may deem important to the rights of the applicant or the State.

SECTION 8. In the event the surface of an area included within the operations of this Act has heretofore been or may hereafter be acquired by one prior to the filing of an application under the provisions herein such area shall nevertheless be subject to prospect and lease as provided herein but the owner of the permit or lease shall pay to the owner of the surface annually in advance during the life of the permit or lease, ten cents per acre and the sum so paid and accepted by the surface owner shall be full compensation for all damages to the surface.

SECTION 9. Every person or association of persons, corporate or otherwise, applying for a permit, lease or patent shall file with the application a sworn statement showing what interest the applicant has in any other

permit or lease issued by the State and in good standing at the date of the statement.

Coal and Lignite.

(Sections 10-11-12-13-14 and 15 deal solely with the development of minerals other than oil and gas and these sections are not here copied.)

General Provisions.

SECTION 16. The general provisions in this and the following section shall apply to all the foregoing provisions so far as applicable.

Surveyed land within the meaning of this Act shall include all tracts for which there are approved field notes on file in the General Land Office and eighty acre tracts and multiples thereof of such surveys.

Unsurveyed areas within the meaning of this Act include all areas for which there are no approved field notes on file in the General Land Office.

All applications for surveyed land shall be filed with the clerk of the county in which the tract or a portion thereof is situated or with the clerk of the county to which such county may be attached for judicial purposes and accompanied by one dollar filing fee, and it shall be filed in the General Land Office within thirty days after it was filed with the county clerk and accompanied by one dollar filing fee.

All applications for unsurveyed areas shall be filed with the county surveyor, or his deputy, of the county in which the area or a part thereof is situated, accompanied by one dollar filing fee, but if such county has no surveyor then the application shall be filed with the

clerk of the proper county and by him recorded in the surveyor's records, and in that event the area may be surveyed by the surveyor of the nearest county as now provided by law. The area shall be surveyed within ninety days and the application, field notes and plat shall be filed in the General Land Office, accompanied by a filing fee of one dollar, within one hundred days after the date of the filing of the application.

The payment per acre required to be made before the issuance of a permit shall be paid annually thereafter during the life of the permit or lease.

A separate written application shall be made for the area desired in a permit. No permit, lease or patent shall embrace the area in two or more applications.

No application, permit, lease or patent shall embrace a divided area.

Whole tracts of surveyed land may be applied for as a whole or in eighty-acre tracts or multiples thereof without furnishing field notes therefor.

A duplicate of every permit and lease shall be kept in the General Land Office.

The area in each permit shall be developed independently of other areas.

When one desires a lease or patent any one or more whole tracts in the permit may be abandoned by relinquishment filed in the General Land Office as herein provided and thereupon obtain a lease or patent upon the remaining area; provided such remaining area is in a solid body.

An owner may relinquish a permit or lease at any time by having the deed of relinquishment acknowledged, recorded by the proper county clerk and filed in the General Land Office accompanied by one dollar filing

fee. The Commissioner of the General Land Office shall mail notice to the proper County Clerk of the filing of the relinquishment and when said notice has had time through due course of mail to reach said clerk the area shall be subject to applications as in the first instance.

SECTION 17. The proceeds arising from activities under this Act which affects land belonging to the public free school fund, the permanent University fund and the permanent fund of the several asylums shall be credited to the permanent fund of said institutions and the proceeds arising from the activities affecting other areas shall be credited to the Game, Fish and Oyster Fund.

SECTION 18. The owner of a file or permit or lease under any provision of this Act may sell same and the rights secured thereby at any time, also fix a lien of any kind thereon to any person, association of persons, corporate or otherwise, who may be qualified to receive a permit or lease in the first instance; provided, the instrument evidencing the sale or lien shall be recorded in the county where the area or part thereof is situated or in the county to which such county may be attached for judicial purposes and same shall be filed in the General Land Office within sixty days after the date thereof accompanied with a filing fee of one dollar, and if not so filed the contract evidenced by said instrument shall be void and the obligations therein assumed shall not be enforceable; provided further, a sublease contract need not be filed in the General Land Office.

SECTION 19. If a permit or lease should be issued upon a statement by the applicant which is false or untrue in material matters, or should the owner of a permit fail or refuse to begin in good faith the work necessary to

the development of the area within the time required, or should the owner of a permit fail or refuse to proceed in good faith and with reasonable diligence in a bona fide effort to develop an area included in his permit after having begun the development, or should the owner of a permit fail or refuse to apply for a lease within the prescribed time, or should the owner of a lease fail or refuse to proceed in good faith and with reasonable diligence and in a bona fide effort to develop, operate and put out the mineral or other substance at any time during the life of the lease, or should the owner of a lease fail or refuse to make proper remittance in payment of royalty or other payments or fail or refuse to make the proper statement, or fail to furnish the required evidence of the output and market value and material matters relating thereto when requested, or fail to make the annual payment on the area when requested so to do the permit or lease, as the case may be, shall be subject to forfeiture, and when the Commissioner is sufficiently informed of the facts which subject the permit or lease to forfeiture he may declare same forfeited by proper entry upon the duplicate permit or lease kept in the General Land Office. When forfeiture has been declared a notice of that fact shall be mailed to the proper county clerk and the area shall be subject to the application of another than the forfeiting owner when the notice has had time to reach the county clerk through due course of mail; provided, the Commissioner may exercise large discretion in the matter of requiring one to develop gas wells, and provided further, that all forfeitures may, within the discretion of the Commissioner be set aside and all rights reinstated before the rights of another intervene.

SECTION 20. An owner of any claim for any mineral or substance included in this Act may fell and remove for building or mining purposes any timber upon any of the unsold areas included within this Act, and shall also have the right to occupy within the limits of his application, permit or lease, so much of the surface thereof as may be necessary for the development of the minerals and substances therein, and shall have the right of ingress, to and and from the area embraced in the file, permit, lease or patent. Ten cents per acre shall be paid to the owner of the surface and when accepted by the owner, it shall be deemed full compensation for such damages as may be occasioned to the surface through the occupancy and operation by the owner of the permit, lease or patent.

SECTION 21. Neither the filing of an application under any provision of this Act nor the issuance of a permit or lease on any of the unsold land included herein shall prevent the sale of the surface without the minerals and in case of such sale subsequent to the posting of any notice or the filing of an application the purchaser shall not be entitled to the ten cents per acre that is provided for owners of the surface at the time of filing nor shall such owner be entitled to any damages that may be occasioned by the working of any area.

SECTION 22. All development in water or on islands, marshes, reefs or river beds and channels shall be done under such regulations as will prevent the pollution of the water and for the prevention of such pollution the Commissioner of the General Land Office may call upon the Game, Fish and Oyster Commissioner for assistance in the adoption and enforcement of rules and regulations for the protection of the waters from such pollution.

The Commissioner of the General Land Office, may cancel a claim, location, file, permit or lease or patent for a failure or refusal of the owner to comply with such rules and regulations as may be adopted.

SECTION 23. Should any mineral or substance within the provisions of this Act, other than those included in the permit or lease under which one is operating, be discovered while the area is being worked for the minerals and substances embraced in such permit or lease, the owner thereof shall have a preference right for sixty days after such discovery in which to file on the area allowed one for such mineral or other substance by complying with the provisions of this Act relating to the mineral or substance so discovered, but shall not be required to pay either of the additional ten cents per acre to the State or the owner of the surface, and the remaining portion of said area shall be subject to the application of others in the same manner as if there were no pre-existing file thereon.

SECTION 24. If the owner of a claim upon any mineral or other substance named in this Act, other than petroleum and natural gas which has been acquired under any previous statute, should desire to accept the provisions of this Act and operate hereunder he may do so by filing a declaration to that effect in the General Land Office together with the payment required in the particular instance and obtain a permit or lease by complying with the provisions hereof relating thereto. The rights under such acceptance shall begin from the date the declaration is filed and the owner shall have the same rights thereafter as is accorded those who make original filings under this Act.

SECTION 25. At any time during the life of a permit

but prior to accepting a lease upon any area for any mineral or other substance included within the provisions of this Act, except petroleum and natural gas, the owner of a permit may elect to pay one hundred dollars per acre for the area embraced in his permit and obtain under the rules governing the issuance of patents to land, a patent for all the minerals that may be in such area except petroleum and natural gas in lieu of the payment of the royalty as provided in this Act; provided, however, one shall pay the prescribed royalty on all minerals and substances put out and disposed of while developing the area prior to obtaining a lease or patent.

SECTION 26. The Commissioner of the General Land Office shall have the general supervision of all matters necessary for the proper administration of this Act and he is authorized to adopt rules and regulations and to alter or amend them from time to time as he may deem necessary for the protection of the interests involved and not inconsistent with the provisions herein.

SECTION 27. Rights acquired under this Act shall be subject to taxation as is other property.

SECTION 28. Chapter 173 approved April 9, 1913, and all other laws and parts of laws in conflict with this Act are hereby repealed.

SECTION 29. The fact that portions of the mineral statute are so incongruous and difficult of interpretation as to be almost inoperative and the fact that a law clear in its terms and ample to secure the development of the State's mineral wealth is badly needed and the near approach to the close of the session creates an emergency and an imperative public necessity exists that the constitutional rule which requires bills to be

read on three several days in each house be suspended and that this take effect from and after its passage and it is so enacted.

APPROVED March 16, 1917.

APPENDIX D

ACT OF MARCH 10, 1925, CHAPTER 71, PAGE 225, REGULAR SESSION, 39TH LEGISLATURE

An Act for the sale of oil and gas leases on university land and to provide for the extension of the time for the expiration of oil and gas permits heretofore issued on university land and the issuance of leases thereon without the payment of any further sum except royalty, and declaring an emergency.

Be It Enacted By the Legislature of the State of Texas:

SECTION 1. That all university land now unsold and all of said land that has heretofore been sold with reservation of the minerals therein and that which may hereafter be sold with reservation of the minerals therein, whether known or unknown, shall be included in this Act and leases thereon conferring upon persons, firms and corporations the right to develop the oil and natural gas that may be in said land shall be subject to sale by the Commissioner of the General Land Office in accordance with the provisions of this Act and under such rules and regulations as may be adopted by said commissioner as may be necessary to the proper execution of its purposes; provided, oil and gas permits and leases outstanding shall not be affected by this Act except as provided in Section 14 hereof.

SEC. 2. Sales of oil and gas leases on the lands included herein shall be made by the Commissioner of the General Land Office not less than once each month, when there is land in demand, and at 10 o'clock A. M. on the day fixed therefor. Sales of leases shall be for ten cents per acre in advance for the first year and twenty-five cents per acre in advance for the second year and fifty cents per acre in advance each year there-

after until production is secured in paying quantities, but not to exceed five years, and a royalty of one-eighth of the gross production of the oil, or the value thereof, produced and saved from the leased premises delivered into such pipe line as the lessee may connect his well, or wells, and one-eighth of the gross production of gas, or the value thereof, produced and sold off the leased premises and in addition thereto such sum, if any, that one may pay therefor as provided herein.

SEC. 3. The commissioner shall advertise the land and the time when the mineral lease will be subject to sale, except as elsewhere provided in the event of tie bids. If there should be no other sufficient means for giving the necessary publicity as to what tracts will be subject to lease and the time when applications may be delivered to the General Land Office, the Commissioner shall have lists of such tracts printed for free distribution at the expense of the State, which expense shall be paid out of the appropriation for public printing. Such lists shall contain a brief designation of the tracts subject to lease and the terms upon which they may be leased and the time when applications therefor will be opened and filed in the General Land Office.

SEC. 4. Separate applications for each tract with one dollar for county clerk recording fee, and the first payment of ten cents per acre and the sum offered in addition thereto, if any, for any tract shall be delivered into the General Land Office on or before the day and hour on which the lease will be subject to sale in sealed envelopes on which shall be endorsed in substance "Application to Buy Oil and Gas," and in addition thereto the time the lease will be subject to sale. All envelopes so endorsed shall be securely kept by the

Commissioner or his chief clerk unopened until the date on which applications are to be opened and at said hour either or both of them shall begin to open the envelopes in the presence of such persons as may desire to be present. All applications received up to the opening hour, whether open or sealed, endorsed or not endorsed, shall be considered as properly delivered into the General Land Office. An application which includes two or more tracts or is for a price less than the fixed royalty and ten cents per acre shall be void. When an application shall have been filed and considered and the land found to be subject to lease, the lease shall be issued for a term not to exceed five years to the applicant that pays the most, if any sum, for the area in addition to the ten cents per acre and the stipulated royalty. If production should not be secured in five years the lease shall terminate and another lease on the land again be subject to sale as in the first instance. A duplicate of the lease shall be kept on file in the General Land Office. All leases shall be forwarded by the Commissioner, with one dollar recording fee, to the proper county clerk, who shall record same and deliver the lease to the lessor or his agent. If two or more persons should offer the same price for the same area and the same should be the highest price offered, all shall be rejected and a date fixed within the discretion of the Commissioner, but not more than fifteen days after rejection, when a lease on the land will be subject to sale as in the first instance; provided no lease shall be sold for a sum less than the tie bid without the tract having been duly advertised and offered for sale on a regular sale date. All sums paid upon rejected applications shall be returned by the State Treasurer.

SEC. 5. Whenever production is secured in paying quantities and the payment of royalty begins, the owner shall not pay any further annual rental. After production is secured in paying quantities, the owner shall be entitled to an absolute lease which shall run so long as the area produces in paying quantities, subject only to the provisions of this Act. Whenever a lease ceases to produce in paying quantities or the owner fails to pay to the State the royalty due, it shall be subject to forfeiture by the Commissioner, and when sufficiently informed of the facts which authorize a forfeiture he shall forfeit it and the area shall be again offered for sale as in the first instance.

SEC. 6. Royalty of one-eighth of the gross production, as herein provided, shall be paid to the General Land Office for the benefit of the University permanent fund on or before the twentieth day of each month for the preceding month during the life of the lease, and it shall be accompanied by the sworn statement of the owner, manager or other authorized agent showing the gross amount of oil produced and saved since the last report and the amount of gas produced and sold off the premises, and the market value of the oil and gas together with a copy of all daily gauges of tanks, gas meter readings, if any, pipe line receipts, gas line receipts and other checks or memoranda of amount produced and put into pipe lines, tanks or pools and gas lines or gas storage. The books and accounts, the receipts and discharges of all lines, tanks, pools and meters, and all contracts and other records pertaining to the production, transportation, sale and marketing of the oil and gas shall at all times be subject to inspection and examination by the Commissioner of the General Land

Office, the Attorney General, the Governor or member of the Board of Regents of the University of Texas, or the representative of either.

SEC. 7. Royalty and all other sums shall be due and payable to the State at Austin, Texas, and shall be paid to the Commissioner of the General Land Office and he shall transmit all remittances in the form received to the State Treasurer, who shall credit the permanent University fund with all amounts received from royalty. All payments shall be in the form of cash, bank draft on some State or National bank in Texas, or post office or express money order, or such other forms as may be collectible in Austin.

SEC. 8. The State shall have a first lien upon all oil and gas produced upon any leased area to secure the payment of all unpaid royalty and other sum or sums of money that may be due and become due under the provisions of this Act and may follow the same and the value thereof into the hands of any purchaser.

SEC. 9. If oil or gas should be produced in commercial quantities in a well on an adjoining area whether privately owned, or covered by separate lease, which well should be within five hundred feet of an area leased under this Act, the owner of the lease on such University area shall, within sixty days after the initial production on such privately owned area, begin in good faith and prosecute diligently the actual drilling of an offset well or wells on the area so leased from the State and such offset well or wells shall be drilled to such depth and under such conditions as may be necessary to prevent the undue drainage of oil and gas beneath such University area. A log of such well, whether producer or non-producer, shall be filed in the General Land Office

within thirty days after the well has been completed or abandoned.

SEC. 10. One may transfer his lease at any time or a part thereof in any size tract not less than forty acres and such transfer shall be recorded in the county or counties in which the area or part thereof is situated and the recorded transfer or certified copy of same shall be filed in the General Land Office accompanied by one dollar as filing fee and ten cents per acre for each acre in the transfer and thereby the assignee shall have his portion separated from the other part and succeed to all the rights and be subject to all the obligations and penalties of the original lessee. The ten cents per acre as a transfer fee shall be deposited into the State Treasury to the credit of the available University fund, and the lease rental and the bonus paid by a purchaser shall be deposited in the State Treasury to the credit of the University permanent fund.

SEC. 11. An owner may relinquish his lease to the State at any time by having the relinquishment recorded in the county or counties in which the area or part thereof is situated and the recorded relinquishment or certified copy of same shall be filed in the General Land Office accompanied by one dollar as filing fee, and thereby the owner of such lease shall be relieved of any further obligations to the State but such relinquishment shall not have the effect to release the owner from any obligations or liabilities theretofore accrued in favor of the State. The area so relinquished shall be subject to lease as in the first instance.

SEC. 12. If the owner of a lease should fail or refuse to make the payment of any sum due thereon either as rental or royalty on the production within thirty days

after same shall become due, or if such owner or his authorized agent should make any false return, or false report concerning production, royalty or drilling, or if such owner should fail or refuse to drill any offset well or wells in good faith as required by this Act, or if such owner or his agent should refuse the proper authority access to the records or other data pertaining to the operations under this Act, or if such owner or his authorized agent should fail or refuse to give correct information to the proper authority, or fail or refuse to furnish the log of any well as provided herein, such lease shall be subject to forfeiture by the Commissioner of the General Land Office, and when sufficiently informed of the facts which authorized a forfeiture, the Commissioner shall forfeit same, and the area shall be subject to lease again after due advertisement; provided such forfeiture may be set aside and the lease and all rights thereunder reinstated before the rights of another intervene; upon satisfactory evidence of future compliance with the provisions of this Act and the rules and regulations authorized to be adopted for the purpose of executing its provisions.

SEC. 13. Whenever it may be necessary for the owner of a lease to enter the enclosed land of another for the purpose of ingress and egress to and from the area so leased from the State, and such lessee and owner of enclosure or agent of the owner cannof agree upon the terms or place of entry, the lessee or his agent may petition the Commissioners Court of the county or counties in which such enclosure may be situated in whole or in part for the opening of such way of ingress and egress aforesaid as may be necessary. Upon the filing of such petition it shall be the duty of said court or courts to

proceed to lay out and establish in the manner provided for the laying out of third class public roads, such road or roads as may be necessary for the purposes named herein.

SEC. 14. All oil and gas permits heretofore issued upon lands included herein and now in force shall be extended for a term of five years from date thereof and whenever production is secured in paying quantities and the payment of royalty begins, the owner shall not pay any further annual money rental. After production is secured in paying quantities the owner shall be entitled to a lease which shall run so long as the area covered by his lease produces oil or gas in paying quantities, subject to the provisions of this Act.

SEC. 15. The importance of this proposed legislation and the near approach of the close of this session creates an emergency and an imperative public necessity that the rule requiring bills to be read on three separate days in each House be suspended, and that this Act be placed upon its third reading and final passage and take effect from and after its final passage, and it is so enacted.

(NOTE: The enrolled bill shows that the foregoing Act passed the House, 102 yeas, 5 nays; passed the Senate, 27 yeas, 0 nays.)

Approved March 10, 1925.

Effective March 10, 1925.

APPENDIX E

Act of March 31, 1927, 40th Legislature, Page 368

Chapter 249.

WHEREAS, there are now pending in the Supreme Court of Texas two petitions for mandamus against J. T. Robison, Commissioner of the General Land Office in which Geo. W. Theisen and S. Rosa Frank as Relators are seeking to compel the said Commissioner to issue to each an oil and gas permit for the development of those substances under their applications heretofore filed on University land at ten cents per acre and one-eighth royalty under the Act of March 16, 1917, for the alleged reason the Act of March 10, 1925, providing for the sale of oil and gas leases on University land is unconstitutional, and

WHEREAS, the Regents of the University have joined in the attack upon the 1925 Act and if the effort to destroy said Act should be successful and resort have to be had to the Act of 1917 for the development of oil and gas on University land the estimated loss to the University fund amounts to a few million dollars, now, therefore

S. B. No. 474.

An Act to withdraw from sale the oil and gas in University land until such time as the Legislature may enact laws deemed adequate to protect the interest of the University in its available and permanent funds, on the condition only that the University mineral lease or sales Act of March 10, 1925, *Chapter* 71, *Acts of Regular Session, 39th Legislature, shall be held invalid or ineffective by the Supreme Court of Texas in suits now pending or that may hereafter be filed; and in that event prohibiting the Commissioner of the General Land Office from issuing any oil and gas per-*

mit upon any application heretofore or hereafter filed, and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. If, in cases now pending in the Supreme Court or in cases hereafter filed, the said court should decide that the mineral lease or sales Act of March 10, 1925, Chapter 71, Acts Regular Session, 39th Legislature, is invalid or ineffective, then and in that event the minerals in all University land are hereby withdrawn from lease or sale until such time as the Legislature may enact legislation deemed adequate for the protection of the University available and permanent funds; and the Commissioner of the General Land Office shall not, in the event such sales Act is declared unconstitutional, thereafter issue any oil and gas permits on said land upon any application heretofore or hereafter filed, until further legislation as to same.

SEC. 2. The manifest importance of this legislation and the crowded condition of the calendar, creates an emergency and an imperative public necessity exists that the constitutional rule requiring bills to be read on three separate days in each House be suspended and that this be placed upon its third reading and final passage and take effect from and after passage, and it is so enacted.

Approved March 31, 1927.

Effective March 31, 1927.

APPENDIX F

Act of January 11, 1929, 41st Legislature, Page 6.
Chapter 2.

S. B. No. 7.

An Act repealing Chapter 71 of the Acts of the Regular Session of the Thirty-ninth Legislature. Further providing for a withdrawal from lease or sale of all oil and gas in University lands until such time the legislature may enact laws deemed adequate for the protection of the University fund, especially withdrawing from sale or lease oil and gas in University lands advertised for sale for January 2, 1929, as well as for later times during the month of January, and further requiring the Commissioner not to consider any of the applications filed for lease or purchase of such oil and gas so advertised, and further requiring him to forthwith return the applications so filed, together with remittances made therein and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. Chapter seventy-one (71) of the Acts of the Thirty-ninth Legislature is hereby in all things repealed, and all oil and gas in University lands is hereby withdrawn from lease or sale until such time as the legislature may enact laws deemed adequate for the protection of the University funds, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 2. Oil and gas in University lands advertised

for sale for January 2, 1929, the date of sale of which was afterwards postponed to January 22, 1929, is specifically withdrawn from sale or lease, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 3. Oil and gas in University lands advertised for sale for January 2, 1929, the sale of which was not postponed, is also specifically withdrawn from sale, or lease, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 4. Oil and gas in University lands advertised for sale for the various days in January, 1929, beginning with January 16th, and other days subsequent thereto in January, is also specifically withdrawn from sale, and it is hereby declared to be the duty of the Land Commissioner not to consider applications filed for the purchase or lease of such oil and gas, but upon the contrary it shall be his duty to return all such applications, together with remittances made to the applicants without making any record of the terms offered.

SEC. 4-a. If any provision or Section of this Act be declared invalid or unconstitutional the same shall not

affect any other portion or provision thereof, and all other provisions shall remain valid and unaffected by any invalid provision, if any.

SEC. 5. The necessity for the immediate protection of the University funds creates an emergency and an imperative public necessity that the rule requiring bills to be read on three several days be suspended, and that this Act shall take effect and be in force from and after its passage, and it is so enacted.

(NOTE—S. B. No. 7 passed the Senate, 27 yeas, 0 nays; passed the House, 119 yeas, 0 nays.)

Approved January 11, 1929.

Effective January 11, 1929.

APPENDIX G

Act of March 29, 1929, 41st Legislature, Page 616.
Chapter 282.

S. B. No. 82.

An Act to provide for the sale of oil and gas in and on University lands; to create a Board to perform the duties with reference thereto provided hereby; to provide for surveying, dividing and marking of said lands; prescribing duties of the Board of Regents of the University of Texas and of the Commissioner of the General Land Office of the State of Texas, authorizing the employment of geologists and mineralogist, and other employees, and making an appropriation, and repealing all laws in conflict herewith, and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. A Board is hereby created to consist of the Commissioner of the General Land Office and two members of the Board of Regents of the University of Texas, neither of whom is employed either directly or indirectly by any oil or gas company, nor is an officer or attorney thereof, to be selected by said Board of Regents, who shall perform the duties hereinafter indicated; the Board shall be known as "Board for Lease of University Lands." The term "Board" wherever it appears hereafter in this Act shall mean "Board for Lease of University Lands." The Board shall keep a complete public record of all its proceedings.

SEC. 2. It is hereby made the duty of the Board to cause to be done such surveying or re-surveying of the blocks and subdivisions thereof of the University lands as may be necessary to enable the lines of the blocks and sections and fractional sections to be determined

and identified and have such corners as may be necessary to that end permanently marked. When it is impracticable to establish such lines and corners as originally surveyed, or when such sections have not been actually surveyed on the ground, the blocks shall be surveyed or re-surveyed and divided into surveys of sections and fractional sections and as many corners thereof as may be necessary for the identification shall be permanently marked. The surveyors employed to do such surveying shall be approved by said Board. The field notes of such surveys shall be returned to the General Land Office, and when correct and in accordance with law, shall be approved by the Commissioner, filed in the General Land Office and become archives therein.

SEC. 3. The oil and gas in the University land shall be subject to sale on and after June 1, 1929, under the regulations, at the times and on the terms provided herein, together with such rules and regulations as may be authorized herein to be adopted by the Board, but not inconsistent with the provisions of this Act.

SEC. 4. Whenever there shall be such demand for the purchase of the oil and gas in any one or more separate whole surveys of sections or fractional sections of University land as will reasonably insure that said oil and gas may be sold advantageously, the Board shall place said oil and gas in said lands on the market in separate whole surveys only or in subdivisions of said surveys. It shall cause to be advertised a brief description of the lands from which the oil and gas is proposed to be sold and that sealed bids for the purchase of said oil and gas by lease will be opened at a designated day, at ten o'clock A. M. on that day, and that sealed bids

received up to that time will be considered. Said advertisement shall be made:

(*a*) By insertion in two or more papers of general circulation in this State.

(*b*) By mailing a copy thereof to the County Clerk and County Judge of every county in this State.

(*c*) In addition to the two foregoing mandatory provisions, the Board may in its discretion, cause said advertisement to be placed in oil and gas journals in and out of the State and to be mailed generally to such persons as they think might be interested.

SEC. 5. All bids shall be directed to the said Board in care of the General Land Office of the State of Texas, and shall be retained by the Commissioner of the General Land Office until the day designated for the opening of bids and upon that day the said Board, or a majority of its members shall open said bids and shall list and file and register all bids and money received. A separate bid shall be made for each whole survey or sub division thereof. No bid shall be accepted which offers a royalty of less than one-eighth of the gross production of oil and gas in the land bid upon, and this minimum royalty may be increased at the discretion of the Board, all members concurring, before the promulgation of the advertisement of the land. Every bid shall carry the obligation to pay an amount not less than ten cents per acre for delay in drilling, such amount to be fixed by the Board in advance of the advertisement, and which shall be paid every year for five years, unless in the meantime production in paying quantities is had upon the land.

SEC. 6. Every bid shall be accompanied by a payment equal to the minimum price fixed on the land per

acre for delay in drilling of the land bid for, which amount will constitute the first year rental payment for delay in drilling if the bid is accepted. The bid shall further indicate the royalty the bidder is willing to pay, which royalty shall not be less than one-eighth of the gross production. The bid shall further name such amount as the bidder may be willing to pay in addition to the royalty and the annual payment herein provided for, and shall be accompanied by cash or checks collectible in Austin to cover said amounts.

SEC. 7. If any one of the bidders shall have offered a reasonable and proper price therefor, not less than the price fixed by the Board, the lands advertised, or any whole survey or subdivision thereof, may be leased for oil and gas purposes under the terms of this Act and such regulations as the Board may prescribe, not inconsistent with the provisions of this Act. If after any bidding by sealed bids the Board should reject all bids, as it is hereby authorized to do, it may thereafter offer for sale and sell the oil and gas in said lands, in separate whole surveys only or subdivisions thereof, by open public auction to be held at a time and place designated by the Board and after adequate and proper notice, but no disposition shall be made of said oil and gas in said lands at such public auction at a price less than the price offered by the sealed bids. All bids may be rejected. In the event of no sale at public auction, any subsequent procedure for the sale of said oil and gas leases shall be in the manner above provided.

SEC. 8. If the Board shall determine that a satisfactory bid has been received for said oil and gas, it shall make an award to the applicant, offering the

highest price therefor, and a lease shall be executed by the Commissioner of the General Land Office, a duplicate copy of such lease shall be filed in the General Land Office. Whenever the royalties shall amount to as much as the yearly payment as fixed by the Board, the yearly payment may be discontinued. If before the expiration of three years oil and gas in paying quantities shall not have been produced, the lease shall terminate. The lease shall include such additional provisions and regulations as the Board may prescribe to preserve the interest of the State and safeguard the interests of the University funds, but not inconsistent with the provisions of this Act.

SEC. 9. If during the term of any lease issued under the provisions of this Act the lessee shall be engaged in actual drilling operations for the discovery of oil and gas on land covered by any such lease, no rentals shall be payable as to the tract on which such operations are being conducted so long as such operations are proceeding in good faith; and in the event oil or gas is discovered in paying quantities on any tract covered by any such lease, then the lease as to such tract shall remain in force so long as oil or gas is produced in paying quantities from such tract. In the event ofthe discovery of oil or gas on any tract covered by a lease issued hereunder or on any land adjoining same, the lessee shall conduct such operations as may be necessary to prevent drainage from the tract covered by such lease and to properly develop the same. Failure to comply with the obligations provided by this section shall subject the holder of the lease to the penalties provided in Sections 12 and 13 of this Act.

SEC. 10. Title to all rights purchased may be held by

the owners so long as the area produces oil and gas in paying quantities. All rights purchased may be assigned in quantities of not less than forty acres, unless there be less than forty acres remaining in any survey, in which case such lesser area may be so assigned. All assignments shall be filed in the General Land Office within one hundred days after the date of the first acknowledgment thereof, accompanied by ten cents per acre for each acre assigned, and if not so filed and payment made, the assignment shall be ineffective. All rights to any whole survey and to any assigned portion thereof may be relinquished to the State at any time by having an instrument of relinquishment recorded in the county or counties, in which the area may be situated and filed in the Land Office accompanied with one dollar for each area assigned, but such assignment shall not relieve the owner of any past due obligations theretofore accrued thereon. The Board shall authorize the laying of pipe lines, telephone lines and the opening of such roads over the University lands as may be deemed reasonably necessary for and incident to the purposes of this Act.

SEC. 11. Royalty as stipulated in the sale shall be paid to the General Land Office at Austin, Texas, for the benefit of the University Permanent Fund on or before the 20th day of each succeeding month for the preceding month during the life of the rights purchased and it shall be accompanied by the sworn statement of the owner, manager or other authorized agent showing the gross amount of oil produced and saved since the last report and the amount of gas produced and sold off the premises and the market value of the oil and gas, together with a copy of all daily guages of tanks,

gas meter readings, pipe line receipts, gas line receipts, and other checks and memoranda of the amounts produced and put into pipe lines, tanks or pools and gas lines or gas storage. The books and accounts, receipt and discharges of all wells, tanks, pools, meters, pipe lines and all contracts and other records pertaining to the production, transportation, sale and marketing of the oil and gas shall at all times be subject to inspection and examination by the Commissioner of the General Land Office, the Attorney General, the Governor, or any member of the Board of Regents of the University of Texas, or the representative of either.

SEC. 12. In every case where the area in which the oil and gas sold shall be contiguous or adjacent to land not University land, the acceptance of the bid and the sale made thereby shall constitute an obligation on the owner thereof to adequately protect the land leased from drainage from adjacent lands. In cases where the area in which the oil and gas is sold is contiguous to other University lands leased or sold, at a lesser royalty, the owner shall likewise protect the State from drainage from the land so leased or sold for a lesser royalty. Upon failure to protect the land from drainage as herein provided the sale and all rights thereunder may be forfeited by the Board in the manner elsewhere provided herein for forfeitures.

SEC. 13. If the owner of the rights acquired under this Act shall fail or refuse to make the payment of any sum due thereon, either as rental or royalty on the production within thirty days after same shall become due, or if such owner or his authorized agent should make any false return or false report concerning production, royalty or drilling, or if such owner shall fail

or refuse to drill any offset well or wells in good faith, as required by his lease, or if such owner or his agent should refuse the proper authority to access to the records and other data pertaining to the operations under this Act, or if such owner, or his authorized agent, should fail or refuse to give correct information to the proper authorities, or fail or refuse to furnish the log of any well within thirty days after production is found in paying quantities, or if any of the material terms of the lease should be violated, such lease shall be subject to forfeiture by the Board by an order entered upon the minutes of the Board reciting the facts constituting the default, and declaring the forfeiture. The Board may, if it so determines, have suit instituted for forfeiture through the Attorney General of the State. Upon proper showing by the forfeiting owner, within thirty days after the declaration of forfeiture, the lease may, at the discretion of the Board and upon such terms as it may prescribe, be reinstated. In case of violation by the owner of the lease contract, the remedy of the State by forfeiture shall not be the exclusive remedy, but suit for damages or specific performance, or both, may be instituted. The State shall have a first lien upon all oil and gas produced upon the leased area and upon all rigs, tanks, pipe line, telephone lines and machinery and appliances used in the production and handling of oil and gas produced thereon, to secure any amount due from the owner of said lease.

SEC. 14. All surveys, files, records, copies of sale and lease contracts, and all other records pertaining to the sales and leases hereby authorized shall be filed in the General Land Office and constitute archives thereof. Payment hereunder shall be made to the Commissioner

of the General Land Office at Austin, Texas, who shall transmit to the State Treasurer all royalty for deposit to the credit of the Permanent University Fund and all rentals for delay in drilling and all other payments, including all filing assignments and reliquishment fees hereunder to the credit of the Available University Fund.

SEC. 15. The Board is authorized to employ a geologist and a mineralogist who shall keep informed with reference to the minerals in University lands and all activities under this and previous leases and sales and shall report to the Board all information gained with reference thereto. The Board is also authorized to employ other necessary employees. The salaries of such employees shall be paid monthly, and no salary shall be paid in excess of six thousand ($6,000) dollars per annum.

SEC. 16. The expenses of executing the provisions of this Act shall be paid monthly by warrants drawn by the Comptroller on the State Treasurer, and for that purpose the sum of twenty thousand ($20,000) dollars or as much thereof as may be necessary is hereby appropriated out of any money in the Treasury not otherwise appropriated until September 1, 1929.

SEC. 17. If any provision hereof should be held unconstitutional, the balance of the Act shall not be affected thereby.

SEC. 18. The Board shall adopt proper forms and regulations rules and contract as will in its best judgment protect the income from lands leased hereunder. A majority of the Board shall have power to act in all cases, except where otherwise herein provided. The Board may reject any and all bids, and shall have

the further right to withdraw any lands advertised for lease prior to receiving and opening bids. Any and all or parts of laws in conflict with this Act are hereby repealed.

SEC. 19. Since there is no law authorizing the sale of oil and gas leases on University lands this fact creates an emergency and an imperative public necessity exists that the constitutional rule requiring bills to be read on three separate days in each House be suspended and that this be placed upon third reading and final passage and take effect from and after passage, and it is so enacted.

(NOTE—S. B. No. 82 passed the Senate, 25 ayes, 0 nays; Senate adopted free conference report, 28 ayes, 0 nays; passed House with amendments, 104 ayes, 23 nays; House adopted free conference report, 103 ayes, 5 nays.)

Approved March 29, 1929.

Effective March 29, 1929.

APPENDIX H

House Bill No. 812 of 1913.

A Bill
To Be Entitled

An Act to Amend Article 7504, Revised Civil Statutes of 1911, by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land, authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.

Be It Enacted by the Legislature of the State of Texas:

SECTION 1. That Article 7504, Revised Civil Statutes of the State of Texas, be amended so as to hereafter read as follows:

ART. 7504. Real property for the purpose of taxation shall be construed to include the land itself, whether laid out in town lots or otherwise, and all the buildings, structures and improvements, and other fixtures of whatsoever kind thereon, and all the rights and privileges belonging or in any wise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same, also all lease-hold interests whereby the lessee, grantee or licensee is authorized to mine and prospect for and take from lands, stone, granite, marble, fossils, minerals of any kind, including oil and gas.

SEC. 2. The fact that the right of the State to tax leasehold interests in lands under which the lessee, grantee or licensee is permitted to prospect for and mine or take from said lands minerals, including oil and gas, is being disputed by the owners of said lease-hold interests, and the State is being forced to have litigation with such persons, therefore the necessity to render the law of this State upon said subject beyond cavil or the possibility of

a doubt, creates an emergency and an imperative public necessity requiring that the constitutional rule requiring bills to be read on three several days in both Houses be suspended, and it is accordingly so done, and that this Act be in force and take effect from and after its passage, and it is so enacted.

Floor Report.

Committee Room, Austin, Texas.
March 19, 1913.

Hon. Chester H. Terrell, Speaker of the House of Representatives:

Sir: Your Committee on Revenue and Taxation, to whom was referred House Bill No. 812, a bill to be entitled

An Act to Amend Article 7504, *Revised Civil Statutes of* 1911, *by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land, authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency,*

Have had the same under consideration, and I am instructed to report it back to the House with the recommendation that it do pass.

MANGUM, *Chairman*,
KIRBY,
SPRADLEY,
BURGES,
(For the purpose of getting before the House only).
ROACH,
LANE,
DOVE,

KENNEDY,
PATTON,
DAVIS,
KING,
POWELL,
DIFFIE.

House Bill 812.

By KENNEDY.

A Bill
To Be Entitled

An Act to Amend Article 7504, *Revised Civil Statutes of* 1911, *by making clear the purpose and intent of the law to tax certain character of lease-hold interests in land authorizing the lessee, grantee or licensee to mine and to prospect for and take from lands stone, granite, fossils, minerals, including oil and gas; and declaring an emergency.*

March 8, 1913, Read first time and referred to Committee on Revenue and Taxation.

TERRELL.

Favorable Floor Report
3-19-13

ROACH.

THE STATE OF TEXAS
DEPARTMENT OF STATE

I, Jane Y. McCallum, Secretary of State, of the State of Texas, do hereby certify that the foregoing is a true and correct copy of

HOUSE BILL No. 812

introduced at the 33rd Legislature; and the report attached thereto with the endorsement thereon, as now appears of record in this Department.

In Testimony Whereof, I have hereunto signed my name officially and caused to be impressed hereon the Seal of State at my office in the City of Austin, this 10th day of April, A. D. 1930.

(SEAL) JANE Y. MCCALLUM,
Secretary of State.

FILE COPY

Office Supreme Court, U. S.
FILED
JAN 8 1931
CHARLES ELMORE CROPLEY
CLERK

No. 425

In the Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, PETITIONER

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 425

GROUP NO. 1 OIL CORPORATION, PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MOTION TO ADVANCE

Comes now the respondent, by his counsel, the Solicitor General, and moves the Court to advance this case for hearing on February 24, 1931, or as soon thereafter as may be possible. In support of this motion the following statement is submitted:

This case presents for the first time before this Court the question whether or not the United States may impose an income tax upon profits realized from the sale of oil and gas produced pursuant to contract between a State and a taxpayer from lands owned by the former, a claim of exemption

31639—31

being asserted on the ground that the taxpayer is an instrumentality or agency of the State.

The State of Texas is granting leases from time to time upon various classes of lands comprising its public domain, and, as pointed out in its motion for leave to file a brief in this case as *amicus curiae* (p. 3), the decision of this Court will vitally affect the entire leasing policy of the State with reference to its public lands.

Precisely similar facts are presented and the same issue pending before the United States District Court for the Western District of Pennsylvania in *Big Lake Oil Co.* v. *Heiner,* No. 6159. Similar issues are pending with reference to oil and gas leases granted by the State of Oklahoma upon its public domain before the Court of Claims of the United States in *Marland* v. *United States,* No. K–322, and before the Court of Appeals of the District of Columbia in *Coronado Oil and Gas Co.* v. *Commissioner,* No. 5115. The same questions are pending before the Court of Appeals of the District of Columbia in *Bear Canon Coal Co.* v. *Commissioner,* No. 5051, and before the United States District Court for the District of North Dakota in *Hobart Iron Co.* v. *United States,* No. 1414, with reference to leases of mineral lands of the States of Colorado and North Dakota, respectively. The issue is therefore one of widespread importance. Its early disposition will not only have a decisive bearing upon pending cases, but will be of benefit to the various States in determining policies with

reference to the sale or leasing of public lands. See motion of State of Texas, above referred to, p. 10.

The petitioner and other lessees are now producing oil and gas upon lands in the State of Texas. This case and the *Big Lake Oil Co. case, supra,* particularly, involve substantial amounts. An additional assessment is pending in the present case. An early determination will be of material value to the petitioner and such other lessees, and also to the Government in the administration of the internal revenue laws.

It should be stated, however, that a primary question to be decided in determining this issue is whether a Texas statute providing that the property "shall be subject to taxation as is other property" is applicable and still in force. If this question is decided in the negative, then the question of the constitutionality of the tax asserted will be involved.

Opposing Counsel concur in this motion.

Respectfully submitted,

THOMAS D. THACHER,
Solicitor General.

JANUARY, 1931.

U. S. GOVERNMENT PRINTING OFFICE: 1931

FILED
SEP 29 1930
CHARLES ELMORE CROPLEY
CLERK

FILE COPY

No. 425

In the Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, PETITIONER

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JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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CITATIONS

Case:

Shaw v. *Gibson-Zahniser Oil Corp.*, 276 U. S. 575 4

Texas Statutes:

Texas act of March 16, 1917 (Texas Laws, 1917, c. 83, p. 518) 3, 4

Texas act of March 10, 1925 (Texas Laws, 1925, c. 71, p. 225) 4

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 425

GROUP NO. 1 OIL CORPORATION, PETITIONER

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE for the United States for the First District of Texas

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the District Court (R. 39–51) is reported in 38 F. (2d) 680. The opinion of the Circuit Court of Appeals (R. 73–75) is reported in 41 F. (2d) 483.

JURISDICTION

The judgment sought to be reviewed was entered on June 18, 1930. (R. 75.) A petition for rehearing was denied on August 1, 1930. (R. 89.) The petition for certiorari was filed on September 6, 1930. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the net income derived by the petitioner from the sale of oil and gas produced from lands held under contract from the State of Texas is subject to Federal income tax.

The primary question to be decided in determining this issue is whether a Texas statute, providing that the property "shall be subject to taxation as is other property," is applicable and still in force. If this question is decided in the negative, then the question of the constitutionality of the tax is involved.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix (pp. *i–lii*) to the brief in support of the petition for certiorari.

STATEMENT

The petitioner brought this action in the District Court for the Western District of Texas to recover income taxes paid under protest for the period beginning July 1, 1924, and ending March 31, 1928. (R. 2.) All of the income on account of which these taxes were collected was derived from the sale of oil and gas produced by the petitioner under instruments designated as "oil and gas leases" from the State of Texas. (R. 5, 33–34.) These leases are dated May 20, 1924 (R. 18), and July 14, 1924 (R. 23). The land upon which the petitioner car-

ried on its operations under these oil and gas leases from the State of Texas is a part of the public domain of that State and before the leases were executed had been appropriated by the State for the support and benefit of the University of Texas. (R. 9, 35.)

The leases in question expressly recite (R. 18, 23) that they are made pursuant to permits issued under the authority of Chapter 83 of the Acts of the Thirty-fifth Legislature of Texas of March 16, 1917. The relation of this statute, and of other Texas statutes, to the question now involved, is discussed in the argument, *infra*, pp. 3–4.

The District Court held that the United States could not constitutionally impose the tax and entered a decree for the petitioner. (R. 39–51, 54.) The District Court did not consider the Texas statute. On appeal, the Circuit Court of Appeals for the Fifth Circuit construed the Texas statute as permitting the tax and reversed the judgment of the court below. (R. 73–75.)

ARGUMENT

The leases in question were made pursuant to the provisions of the Act of the Texas Legislature of March 16, 1917 (Texas Laws, 1917, c. 83, p. 518; set forth at pp. *xii–xxv* of the brief in support of the petition for certiorari.) Section 27 of this Act provides:

> Rights acquired under this Act shall be subject to taxation as is other property.

There can be no question that the State had the power to withdraw from immunity the income from the property in question. *Shaw v. Gibson-Zahniser Oil Corporation*, 276 U. S. 575.

The petitioner contends that the language of Section 27 of the Texas Act of March 16, 1917, *supra*, does not apply to taxation by the Federal Government. Although there is room for argument as to this contention, we submit that it is a question of the interpretation of local law which does not warrant the consideration of this Court.

The petitioner further contends that Section 27 of the Texas Act of March 16, 1917, was repealed before the taxes now in question were levied or became due and payable. Although there was no express repeal, it is contended that the Texas Act of March 10, 1925 (Texas Laws, 1925, c. 71, p. 225; set forth at pp. *xxvi–xxviii* of the brief in support of the petition for certiorari) constituted an implied repeal. Whether this be true or not, we submit that the Act of 1925 by its express terms did not affect leases which had already been executed before the enactment of the 1925 Act. The last clause of Section 1 of the Texas Act of March 10, 1925, contains the following proviso:

> provided, oil and gas permits and leases outstanding shall not be affected by this Act except as provided in Section 14 hereof.

Section 14, referred to in this proviso, has no bearing on the issue in the instant case.

CONCLUSION

The precise question involved is not likely to arise in the future, since the Texas legislation in question has now been repealed; but there is pending in the United States District Court for the Western District of Pennsylvania an identical case involving a tax of over $1,500,000 imposed on income arising from a similar Texas contract.

If the construction of the Texas statute adopted by the Circuit Court of Appeals in the instant case is correct the constitutional questions argued by the petitioner in its brief in support of the petition for certiorari are not present in this case. If those constitutional questions were directly presented we should not oppose the petition for certiorari, but we submit that the question of the interpretation of the various Texas statutes which is primarily involved does not warrant the consideration of this Court.

Respectfully submitted.

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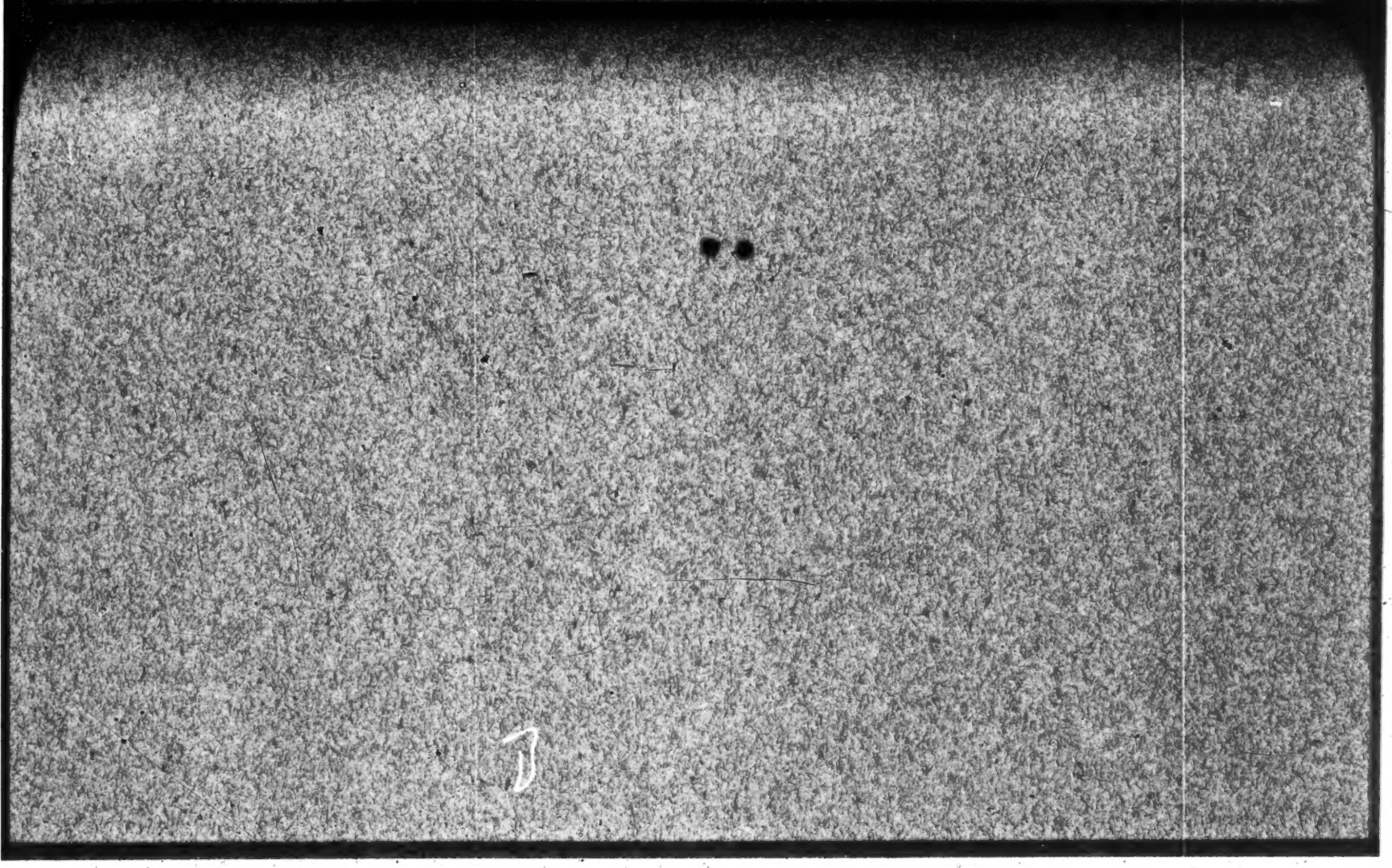

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No. 425

In the Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, PETITIONER

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 27–37) is reported in 38 F. (2d) 680. The opinion of the Circuit Court of Appeals (R. 47–49) is reported in 41 F. (2d) 483.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 18, 1930. (R. 49–50.) A petition for rehearing was denied August 1, 1930. (R. 50.) Petition for a writ of certiorari was filed

September 6, 1930, and was denied October 20, 1930. Upon rehearing the order of denial was vacated and the petition granted on November 24, 1930. (R. 51–52.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Does a state statute providing that "Rights acquired under this Act shall be subject to taxation as is other property" include within its scope Federal taxation?

2. When the highest court of a State has construed a transaction to be a sale of property and not a lease, is the income of the purchaser resulting from the resale of the property subject to the Federal income tax?

3. Assuming that contracts between a State and a private party for the protection of oil and gas upon state lands are mere authorizations to take and use, and not sales of oil and gas in place, do the facts that the lands are owned by the State and that the royalty paid to it is used in support of state governmental activities prevent the Federal Government from imposing a tax upon the net income of the lessee derived from the sale of the oil and gas?

STATUTES INVOLVED

The United States statutes involved are set out in the appendix, *infra*, pages 25–26. The Texas statutes involved are printed at pages 87 *et seq.* of the brief for the petitioner.

STATEMENT

The petitioner, a Delaware corporation, seeks to recover income taxes for the fiscal years and fiscal period beginning July 1, 1924, and ending March 31, 1928, alleged to have been unlawfully collected by the respondent. (R. 1, 2, 22.) Claims for refunds were duly filed. (R. 3, 11–12, 22, 25.) The Commissioner of Internal Revenue rendered no decision thereon within the statutory period of six months, and accordingly this suit was brought. (R. 12, 25.)

A general demurrer and answer were interposed to the complaint. (R. 20–21.) Thereupon a jury was waived in writing (R. 21) and the case was tried on an agreed statement of facts (R. 21–25).

The taxes sought to be recovered were assessed upon income derived from the sale of oil and gas produced by petitioner under the terms of two instruments, one designated "Oil and Gas Lease No. 8560" and the other "Oil and Gas Lease No. 8607" (R. 4, 23–24, 13–16, 17–20), covering lands owned by the State of Texas, and were issued pursuant to the Texas Act of March 16, 1917 (R. 4, 6–7, 22–23, 25). By their provisions the leases were for periods of ten years with renewal privileges, and petitioner was required to pay as compensation for the rights conferred, in addition to a stated amount per acre, a sum of money equal to one-eighth of the value of the gross production of petroleum and a sum of money equal to ten per cent of the value of all gas sold. (R. 7, 14–15, 18, 25.)

The lands involved originally were parts of the public domain of the Republic of Texas, and by the terms of the resolution of Congress consenting to the admission of Texas into the Union title thereto was retained by the State "to be disposed of as said State may direct." A part of the lands so retained by the State was designated by the legislature for the support of the state university pursuant to mandates of the state constitution of 1876 directing the legislature to establish and provide for the support and maintenance of the university and appropriating 1,000,000 acres for that purpose. The lands leased are included therein. (R. 6, 25, 30.)

Upon these facts the District Court gave judgment for petitioner upon the theory that the income was exempt from Federal taxation. (R. 27–38.) Upon review the Circuit Court of Appeals reversed the lower court, holding that by express statutory provision petitioner's rights as lessee were subject to taxation. (R. 47–50.)

SUMMARY OF ARGUMENT

1. Assuming that petitioner's income would otherwise be exempt from Federal taxation, nevertheless it was subjected thereto by Section 27 of the Act of the Texas legislature of March 16, 1917, which provided that "Rights acquired under this Act shall be subject to taxation as is other property." The meaning of Section 27 is clear and unambiguous, and hence is not subject to construction.

It includes within its scope taxation by the Federal Government.

Even if Section 27 were subject to judicial interpretation it could not be construed to refer only to state taxation. Section 27 neither did nor could make anything taxable under Texas laws that was not so without it. Hence unless it applied to Federal taxation it was ineffectual to accomplish anything. A construction will not be adopted that will render a statute nugatory.

2. The Supreme Court of Texas has construed the contracts between petitioner and the State to constitute sales of oil and gas in place. This interpretation is binding upon the Federal courts as a rule of local property law defining property rights between two contracting parties, petitioner and the State. Accordingly, petitioner's income was derived from the sale of private property in which the State held no interest; and hence was taxable in the same manner as that of any other private party derived from the sale of private property.

3. Even if the transactions in question were leases, the income derived by the petitioner from its operations under these leases is not exempt from the Federal income tax. The effect of the tax is too indirect and too remote to constitute an interference with the functions of the State. The tax involved is, we submit, less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, or the tax sus-

tained in *Willcuts* v. *Bunn*, No. 22, October Term, 1930, decided January 5, 1931. The principle involved in these cases has been applied by this Court in numerous other situations.

The decision of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, is not controlling. The case does not decide primarily that income from an oil lease is exempt from taxation, but rather that the particular activity in which the United States was engaged was of such a high governmental nature that even a relatively remote tax upon it was an unconstitutional burden. Nor is the decision in *Long* v. *Rockwood*, 277 U. S. 142, in point. The decision in that case turned upon the peculiar characteristics of a sovereign grant of letters patent, and it can not form a basis for reasoning by analogy in the present case.

ARGUMENT

The constitutional question sought to be raised by petitioner is important only secondarily. The necessity for passing upon it arises only if two primary questions be decided adversely to respondent. These primary questions we discuss first under headings I and II.

I

ANY RIGHT OF EXEMPTION WHICH PETITIONER MIGHT OTHERWISE BE ENTITLED TO ENJOY WAS EXPRESSLY DENIED BY THE STATE OF TEXAS IN THE ACT UNDER WHICH PETITIONER'S LEASES WERE GIVEN

The Circuit Court of Appeals expressed no opinion upon the question of the constitutional right of

the United States to subject petitioner's income to taxation, deeming it unnecessary in view of Section 27 of the Texas Act of 1917, which provided that "Rights acquired under this Act shall be subject to taxation as is other property." It held that the State had thereby waived any exemption that petitioner might claim as an instrumentality of the State, and accordingly reversed the trial court.

Petitioner contends that Section 27 had reference only to state taxation, but concedes (Br. 67, 68) that its terms are sufficiently broad to include Federal taxation. It is clear, of course, that it was entirely within the power of the Texas legislature to subject petitioner's rights under the leases to taxation by the National Government. *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232; *Shaw* v. *Gibson-Zahniser Oil Corp'n.*, 276 U. S. 575. And it is submitted that it acted in the exercise of this power, for otherwise it is only reasonable to suppose that Section 27 would have been limited by its terms to local taxation. And in this connection it is to be noted that the corresponding provision of the 1913 Act (Section 28, Act of April 9, 1913, Laws of Texas, 1913, c. 173), of which the Act of 1917 was an amendment, was equally without limitation.

But petitioner urges that Section 27 should not be held to mean what its language says on the ground that contemporaneous history indicates that the legislature had in mind only state taxation. It is thus sought by construction to limit the literal meaning of the statute. Resort to construction pre-

supposes a necessity therefor. It is not allowable where, as here, the language of the statute is unambiguous. *Ruggles* v. *Illinois*, 108 U. S. 526, 534. Rules of statutory construction "are only admissible to solve doubt * * *." *Wisconsin R. R. Comm.* v. *C., B. & Q. R. R. Co.*, 257 U. S. 563, 589. We admit no necessity for interpretation here. But we proceed to examine the contention.

The difficulty with petitioner's argument is that it makes Section 27 meaningless and ineffectual to accomplish anything. It is one of the first maxims of statutory construction that a statute should not be given an interpretation which will render it nugatory. It is asserted (Br. 63) that the immediate cause of the insertion of Section 28 in the 1913 Act, subsequently retained in the 1917 Act as Section 27, was the fact that litigation was then pending to determine whether or not an interest in an oil and gas lease was taxable property under the laws of Texas. It is pointed out (Br. 64) that the argument was being made that oil and gas before severance were not real property, and hence not within Section 7504 of the Texas Revised Statutes of 1911, which defines real property for purposes of taxation as follows (Br. 64.):

> Real property, for the purpose of taxation, shall be construed to include the land itself, whether laid out in town lots or otherwise, and all buildings, structures and improvements, or other fixtures of whatsoever kind thereon, and all the rights and privileges be-

longing or in anywise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same.

It is at once apparent that neither Section 28 of the 1913 Act nor Section 27 of the 1917 Act could have any effect one way or the other in making oil and gas leases taxable under this statute. If the leases were within its terms, they were taxable as real property; if not, they were not so taxable. Sections 28 and 27, respectively, neither broadened nor restricted the definition contained in Section 7504. And the Supreme Court of Texas finally held (*Texas Co.* v. *Daugherty,* 107 Tex. 226) that interests under oil and gas leases were taxable solely because they came within the terms of Section 7504. If Sections 28 and 27 had reference to state taxation, as petitioner urges, they meant nothing whatever; they neither did nor could make anything taxable under state law which was not already taxable. If the intent of the legislature was to make sure that leasehold interests would be taxable by the State (as petitioner urges it was), the only method of doing so would have been by broadening the statutory definition if it was not then broad enough. This was proposed by House Bill No. 812 (Br. 65) introduced in the legislature March 8, 1913, but was rejected, apparently for the reason that Section 7504 as then existing was deemed broad enough, as was the case. It follows that Sections 28 and 27 were mere gestures unless they referred to Federal taxation.

The court below cited *Shaw* v. *Gibson-Zahniser Oil Corp'n.*, 276 U. S. 575, *supra*, in support of its position. Indian lands were there held to be subject to state taxation under Section 4 of the Act of May 27, 1908, c. 199, 35 Stat. 312, though the statute made no specific reference thereto. Section 4 reads as follows (Br. 69):

> All land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes.

Petitioner criticizes the court's statement that the language of Section 4 is no broader than that of Section 27. We submit that the statement is correct. Section 4 is longer; but it is not more comprehensive than Section 27.

Petitioner urges (Br. 71) that the court below erred also on the ground that its conclusion would lead to the anomalous result that if three lessees should hold leases on three adjoining tracts of university lands—one under the 1917 Act, one under the 1925 Act, and the third under the 1929 Act—the 1917 lessee would be subject to Federal taxation, and the other two would not, since no provision similar to Section 27 appears in the two later acts. The contention affords no proper basis for according to the law something other than its literal meaning. See *Crooks* v. *Harrelson*, 282 U. S. 55, 59–60.

Yet another contention is advanced. (Br. 72 *et seq.*) It is argued that the 1925 Act repealed Sec-

tion 27 of the 1917 Act before any of the taxes now sued for were due. The repeal was by implication, it is urged, the 1925 Act covering the entire field of the 1917 Act. The answer is that the later law expressly provided in Section 1 that "oil and gas permits and leases outstanding shall not be affected by this Act except as provided in Section 14 hereof." Section 14 has no bearing here.

II

NO QUESTION OF TAXATION OF A STATE INSTRUMENTALITY IS INVOLVED AS PETITIONER'S INCOME WAS DERIVED FROM THE INDEPENDENT SALE OF ITS OWN PROPERTY, IN WHICH THE STATE OF TEXAS HELD NO INTEREST

The contracts between the petitioner and the State, though denominated "leases," have been consistently construed by the Supreme Court of Texas to be not mere authorizations of rights to take and use, but sales of oil and gas in place. *Texas Co.* v. *Daugherty,* 107 Tex. 226, *supra; Stephens County* v. *Oil & Gas Co.,* 113 Tex. 160; *Theisen* v. *Robison, Land Commissioner,* 117 Tex. 489. Indeed, under any other construction of the transactions, the Act under which they were authorized would have been unconstitutional under Section 12 of Article 7 of the Texas Constitution, which "requires the Legislature to dispose of the University lands by *sale* only." *Theisen* v. *Robison, Land Commissioner, supra,* at p. 502. We quote from the *Theisen case* (pp. 510–511):

The leases under either act accomplish no unconstitutional diversion of the University's permanent fund. They do not authorize the purchaser to take and use seven-eighths or any other mere fractional part of the oil or gas in the land leased. The purchaser instead buys *all* the oil and gas, for a stipulated price, part of the price being measured by the value of a certain fraction of the *produced* oil and gas, which is a very different thing from the value of that fraction of the oil and gas in place. The leases convey all the oil and gas in granting the right to find, produce, and appropriate *all* of them, in consideration of the payment of stipulated sums and also the value of a stated fraction of the oil and gas produced. The oil and gas when appropriated form no part of the University's permanent fund. While in place, before being sold, the oil and gas were potential assets of the fund. Like any other seller, the State, after parting with its title, no longer owns that which it has sold, but the State receives and turns over all the proceeds of sale when it receives and turns into the permanent University fund the royalties and other payments required by the acts. As a result of the sale, the purchaser owns the oil and gas, and the University permanent fund owns the entire proceeds of their sale.

As a matter of course, the State can sell no part or portion of its lands without diminishing the value of what remains. Should the

> State sell 80 acres out of an 160 acres of uniform value, that which remains would be worth only half the value of the entire tract. But, the State is none the poorer in retaining 80 acres and the proceeds of 80 acres. Exactly the same thing is true when the mineral estate in land is sold separately from the remaining estates, and it belies the experience of mankind throughout the ages to assume that there is any more profitable mode of sale for the realization of the full value of mineral bearing land.

This construction is binding upon the Federal courts in the situation here presented. We are aware of the rule that in applying a Federal taxing statute this Court is not bound by the construction of a local court but is free to make its own interpretation of the nature of any instrument under consideration. *Von Baumbach* v. *Sargent Land Co.* 242 U. S. 503, 518–519; *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110, 114; *B. & W. Taxi. Co.* v. *B. & Y. Taxi. Co.,* 276 U. S. 518, 530. This principle is applicable in situations analogous to those in *Hirschi* v. *United States,* 67 C. Cls. 637, certiorari denied, 280 U. S. 576; and *Burkett* v. *Commissioner,* 31 F. (2d) 667 (C. C. A. 8th), certiorari denied, 280 U. S. 565, where the controversy turned upon whether or not the taxpayers' incomes were within the terms of the Federal taxing statute there in question. On the other hand, however, where the point in controversy relates to property rights as

between two contracting parties, the rule of the local court will be followed in the Federal courts. *Von Baumbach* v. *Sargent Land Co., supra; Waggoner Estate* v. *Wichita County,* 273 U. S. 113, 117. Accordingly, so far as the relationship between petitioner and its lessor is concerned, the interpretation of the Texas court is deemed to be controlling.

It follows that upon the execution of the contracts in question the State had no further control over or interest in the things sold, and that petitioner, from that moment, was the sole and complete owner of the oil and gas as fully as it might be the owner of any other object of property it might buy, whether from a State, a municipality, or some private individual. The source of petitioner's title is unimportant. In producing the income taxed by the United States petitioner was selling its own property, and occupied the same status as any private person would in disposing of his real estate or personalty. The price to petitioner or the manner in which it might have to pay or did pay is immaterial. All the transactions yielding the income upon which the tax in question was laid were parts of an enterprise as fully private in character as any enterprise can be. In *Weston* v. *City Council of Charleston,* 2 Pet. 449, 468, this Court said:

> When lands are sold, no connection remains between the purchaser and the government. The lands purchased become a part of the mass of property in the country, with no

implied exemption from common burdens. All lands are derived from the general or particular government, and all lands are subject to taxation.

Petitioner occupies the same status as did persons who purchased excess army and navy stores from the Federal Government after the late war for resale to the general public. No one would contend that a State might not constitutionally tax the incomes derived from such resales. The source of the dealers' title to the property sold would be without bearing. Equally so is the source of petitioner's title. Petitioner, in the same manner as such dealers, was engaged in an independent private enterprise. As such, its income is taxable.

Willcuts v. *Bunn*, No. 22, October term, 1930, decided January 5, 1931, is closely analogous. There the taxpayer sold municipal bonds to another private party. It was held that this was a transaction distinct from the contracts contained in the bonds themselves. The taxpayer had purchased obligations; they were his private property. And when he transferred them to another, he was dealing with what was his alone—he was making an independent sale of his private rights. So here the sale by petitioner of gas and oil was a transaction distinct from its purchase from the State; the resale was nothing more than a transfer of title to private property by its private owner.

III

EVEN IF THE TRANSACTIONS IN QUESTION WERE LEASES, THE INCOME DERIVED BY THE PETITIONER FROM ITS OPERATIONS UNDER THESE LEASES IS NOT EXEMPT FROM THE FEDERAL INCOME TAX

We contend that even though the petitioner's operations were carried on as a lessee of the State of Texas, the effect of a tax upon the net income of its business is too indirect and too remote to constitute an interference with the functions of the State. The tax is not laid upon the State; the tax is laid upon the petitioner, a private corporation organized for private profit. The tax is not laid upon the petitioner's gross receipts from the leases; it is laid upon the petitioner's net income derived from all its business, including any other business it may have apart from these leases. The tax is not discriminatory; it is laid upon the net income of all individuals throughout the United States. We believe that the decisions of this Court establish that such a tax is not an unconstitutional interference with the functions of a State.

In so far as taxes not directly laid upon a State or its instrumentalities are concerned, the limitation implied from the Constitution is not absolute and must receive a practical construction which permits both the National Government and the state governments to exercise their individual functions without serious impairment or interference. To extend the implied limitation too far is to defeat its very purpose by imposing unnecessary restrictions upon the sovereign power of taxation possessed

by both the state and national governments, and so distinctions must be carefully drawn, and their validity must be judged by the practical effect of the exercise of functions concededly possessed by one government upon the exercise of governmental functions concededly possessed by the other.

The tax involved in this case is, we submit, less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514. Metcalf and Eddy made contracts with States and subdivisions of States under which they performed engineering services with reference to municipal water and sewerage systems, for which they were paid from public funds. Like the petitioner in the present case, the engineers contended they were an instrumentality of the State, but this Court held them to be independent contractors and upheld the Federal income tax imposed on the moneys so received. In its opinion this Court said (pp. 522–523, 524–525):

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself from immunity of taxation on the theory that either he or his property is an instrumentality of government * * *.
>
> * * * * *
>
> The tax is imposed without discrimination upon income whether derived from services rendered to the State or services rendered to private individuals. In such a situation

> it can not be said that the tax is imposed upon an agency of Government in any technical sense, and the tax itself can not be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way.

The same result was reached in two cases decided by this Court at its last term. *Lucas* v. *Howard*, 280 U. S. 526; *Lucas* v. *Reed*, 281 U. S. 699.

If Metcalf and Eddy had been employed to develop and manage the production and sale of oil on state lands, compensation received for such services would certainly have been taxable income. *A fortiori*, lessee's income here involved must be derived from operations under the lease and must be taxable under the Federal statute. Nor can the *Metcalf & Eddy* case be distinguished upon the theory that the lessees are governmental agencies engaged in the performance of governmental functions. It can hardly be said that the construction and maintenance of state or municipal water and sewerage works are less governmental than oil and gas developments or the maintenance of schools. Furthermore, in the *Metcalf & Eddy* case the income taxed was money received directly from the State, while in the instant case the income was derived from sales to third persons and the State's funds are not directly involved.

The principle involved in the *Metcalf & Eddy* case has been applied by this Court and other courts in numerous other situations. Thus, in *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a state franchise.

In *National Bank* v. *United States,* 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake,* 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman,* 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld. And in *James A. Sackley Co.* v. *United States,* 65 C. Cls. 304, it was held that the Federal income tax might be imposed upon receipts derived from a contract with the State to build a schoolhouse.

More recently, in *Willcuts* v. *Bunn,* No. 22, October Term, 1930, decided January 5, 1931, it was decided that the United States could impose a tax upon a profit derived from a sale by a private owner of municipal and state bonds. In that case this Court said:

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds.

Similarly, we submit that the sale of the oil and gas by the petitioner to third persons in the present case is a transaction distinct from the contracts made between the petitioner and the State, and that the

profits on the sales to third persons are in a different category of income from that paid by the petitioner to the State.

See also *Educational Films Corp.* v. *Ward*, No. 350, October Term, 1930, decided January 13, 1931, in which this Court held that a state tax imposed upon the privilege of doing business was not sufficiently burdensome on the Federal Government to be invalid even though the measure of the tax included the income from copyrights.

It should be borne in mind, in determining whether the present tax is a burden upon the State, that the tax is imposed upon net income and not upon gross receipts. This Court has frequently pointed out that a tax on net income does not constitute a direct burden upon the subject from which the income is derived. Thus, in *Peck & Co.* v. *Lowe*, 247 U. S. 165, and in *Barclay & Co*, v. *Edwards*, 267 U. S. 442, it was held that a net income tax may constitutionally be imposed upon the income derived from the business of exporting goods from the United States, although Clause 5 of Section 9 of Article I of the Constitution provides that "No Tax or Duty shall be laid on Articles exported from any State." And it has several times been held that a State may validly lay a net income tax upon income derived from interstate commerce. *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321; *Shaffer* v. *Carter*, 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113.

The petitioner relies principally upon *Gillespie* v. *Oklahoma*, 257 U. S. 501. Broadly speaking,

that case holds that income from an oil lease on restricted Osage Indian lands in Oklahoma can not be taxed by the State. The thought back of the decision is expressed in the decision in *United States* v. *Rickert,* 188 U. S. 432, 437, as follows:

> To tax these lands is to tax an instrumentality employed by the United States for the benefit and control of this dependent race, and to accomplish beneficent objects with reference to a race of which this court has said that "from their very weakness and helplessness, so largely due to the course of dealing of the Federal Government with them and the treaties in which it has been promised, there arises the duty of protection, and with it the power. This has always been recognized by the Executive and by Congress, and by this court, whenever the question has arisen."

The same thought is further expressed in *Shaw* v. *Gibson-Zahniser Oil Corporation,* 276 U. S. 575, in the following language:

> The end sought and the mode of attaining it adopted by Congress in the legislation providing for the welfare of the Indians by setting apart, by allotment and otherwise, tribal lands or the public domain, restricted for their benefit, led to the conclusion that those lands and the uses of them were so intimately connected with the performance of governmental functions as clearly to require independence of all state control so

> complete that nothing short of an express declaration by Congress would have subjected them to state taxation.

See also *Choctaw & Gulf R. R.* v. *Harrison,* 235 U. S. 292, 298; *Indian Oil Co.* v. *Oklahoma,* 240 U. S. 522, 530.

It requires no argument to show that the fulfillment by the United States of its treaty obligations with its dependent Indian wards is a fundamental governmental activity of the highest class, and that is the heart of the *Gillespie* decision. The case does not decide primarily that income from an oil lease of Government lands is exempt from taxation, but rather that the particular activity in which the United States was engaged was of such a high governmental nature that even a relatively remote tax upon it was an unconstitutional burden. Indeed, this definition was pointed out by this Court in its opinion in the *Gillespie* case itself. It was there said (p. 505):

> The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce can not be avoided if the States are to exist and make laws. * *, * *The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance.* (Italics ours.)

And in *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, 613, this Court said:

> It is elementary that the federal government in all its activities is independent of state control. This rule is broadly applied.

In this respect there may well be a distinction between the activities of the United States and those of the States, because the exercise of power conferred upon the United States by the Constitution is necessarily supreme, while the exercise of non-governmental powers by the States is quite as clearly subordinate. *South Carolina* v. *United States*, 199 U. S. 437.

The decision in *Long* v. *Rockwood*, 277 U. S. 142, we submit, is not in point. In that case it was held that a State may not tax royalties derived from a patent granted by the United States. A patent is a sovereign grant and it was accordingly held by a divided court that the patent itself is an instrumentality created by law for the accomplishment of a governmental purpose. There was a sharp dissent in which four members of the court joined with considerable emphasis in declaring that it is not true that patents are instrumentalities of the Government. Thus, the decision turned upon the peculiar characteristics of a sovereign grant of letters patent, and is to be confined to the point decided. It can not form a basis for reasoning by analogy in so far as the case at bar is concerned, for a much closer analogy is found in a grant of land to be used for a governmental purpose. This Court in *Baltimore Shipbuilding & Dry Dock Co.* v. *Baltimore*, 195 U. S. 375, held that land conveyed by the

United States upon condition that the grantee should construct a dry dock thereon and accord to the United States the perpetual use of the dock was subject to direct taxation by the State. See also *Tucker* v. *Ferguson*, 22 Wall. 527; *Forbes* v. *Gracey*, 94 U. S. 762. Personal property used by a private corporation in the performance of a contract with the United States is clearly subject to local taxation. *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, 371.

CONCLUSION

For these reasons it is respectfully submitted that the decision of the Circuit Court of Appeals should be affirmed.

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FEBRUARY, 1931.

APPENDIX

UNITED STATES STATUTES INVOLVED

The Revenue Act of 1924, c. 234, 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954), provides in part as follows:

> SEC. 213. For the purposes of this title, except as otherwise provided in section 233—
>
> (a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.
>
> * * * * *

Section 213 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 23 (U. S. C. App., Title 26, Sec. 954),

is the same as Section 213 (a) of the Revenue Act of 1924 set out above.

The Revenue Act of 1928, c. 852, 45 Stat. 791, 797 (U. S. C. Sup. III, Title 26, Sec. 2022 (a)), provides in part as follows:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> * * * * *

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No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner,*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*

PETITION OF THE PETITIONER FOR A REHEARING OF ITS APPLICATION FOR A WRIT OF CERTIORARI

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PETITION FOR REHEARING OF APPLICATION FOR WRIT OF CERTIORARI

Comes now the above named petitioner, Group No. 1 Oil Corporation, and presents this, its petition for a rehearing of its application for a writ of certiorari in the above entitled cause, and, in support thereof, respectfully shows:

Preliminary Statement.

The District Court in an exhaustive and well considered opinion (R. 39) held that petitioner as a lessee of oil and gas lands of the State of Texas was, under the principal authority of Gillespie v. Oklahoma, 257 U. S. 501, an agency of the State of Texas, and its income from the leases was exempt from the Federal income tax. The Circuit Court of Appeals (R. 73) held that the State, by Section 27 of the 1917 Act under

which the leases were granted waived this constitutional right. Section 27 provided that "Rights acquired under this Act shall be subject to taxation as is other property." The Solicitor General opposed the granting of the writ of certiorari on the sole ground that this case involves merely a construction of Section 27 and that the constitutional questions are not presented. His position was that this case involves only the interpretation of a local law and is therefore not a case for the consideration of this court. He does not discuss the correctness of the decision of the Circuit Court of Appeals, but on the other hand admits "there is room for argument" as to its soundness.

We respectfully take issue with the Solicitor General's statement of this case. As will more fully appear herein, this is a case of paramount national importance, affecting not only a number of pending cases from other States but also the whole leasing policy of the State of Texas and other States, and the rights of lessees both present and future of the public domain of Texas and all other States.

The constitutional rights of petitioner are directly presented. To say that the question of whether these rights have been waived precludes a consideration of whether they existed in the first place is to beg the question. It is of no importance to petitioner to have its constitutional rights recognized in theory and then swept away by an erroneous decision that they have been waived.

We respectfully submit the writ of certiorari should be granted for the following reasons:

I.

National Importance of Case.

This case presents questions of great national importance. It is the first case before this court in which a State oil and gas lessee has asserted its constitutional exemption from Federal taxation on the grounds upon which this court in Gillespie v. Oklahoma, 257 U. S. 501, and the five other cases from Oklahoma, has held that similar lessees from the Federal government were exempt from State taxation. This court has consistently applied the same rule to State and Federal instrumentalities. For example, after holding Federal bonds were exempt from State taxation, this court in Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584, and other cases, held that State bonds were for like reasons exempt from Federal taxation.

In view of the Oklahoma decisions of this court, lessees from not only Texas but other States have logically assumed that they are exempt from the Federal income tax. Some of them are now litigating this question in various courts, and others will continue until this court affirmatively announces whether the rule enunciated in the Oklahoma decisions will be applied in like manner in favor of these State lessees or not. There are now pending the following cases similar to the present one:

1. E. W. Marland v. United States of America, No. K-322, in the Court of Claims of the United States, in which the petitioner sues to recover income taxes paid on income derived from oil and gas leases granted by the State of Oklahoma on State lands.

2. Coronado Oil & Gas Company v. Commissioner of Internal Revenue, No. 5115, in the Court of Appeals

of the District of Columbia, an appeal from an order of the Board of Tax Appeals sustaining an income tax assessed against the company on income from oil and gas leases on Oklahoma State lands.

3. A. T. Jergins Trust v. Commissioner of Internal Revenue, No. 29940, in the Board of Tax Appeals, in which the petitioner claims its income from oil and gas leases granted by the City of Long Beach, California, is exempt.

4. Hobart Iron Company v. United States, No. 1414, in the United States District Court of North Dakota, Fifth Division, in which plaintiff claims the same exemption for its income from leases of iron ore lands of the State of North Dakota.

5. Big Lake Oil Company v. Heiner, Collector, No. 6159, in the United States District Court for the Western District of Pennsylvania, which is a Texas case similar to this cause.

There may be other cases of which we are not informed. In any event lessees in other States will assuredly claim this same exemption until it is affirmatively passed upon by this court.

A decision in this case on the merits after a full presentation will have an important and decisive bearing upon the above mentioned five specific cases. The denial of the application in this case, particularly in view of the nature of the opposition filed by the respondent, leaves the law in doubt.

It is therefore respectfully submitted that this case is of such national importance that the writ of certiorari should be granted in order that the law upon the subject matter may be clearly and finally settled.

II.

Importance to State of Texas and Texas Lessees.

Even if the national importance of the case is excluded, the case is of such importance to the State of Texas and its lessees as to warrant this court in granting the writ applied for.

The State of Texas is granting from time to time leases upon its public lands. If this court follows its decisions in the long line of Oklahoma cases, as it is assumed it will, and holds petitioner's income is exempt, the State will on all future leases receive larger cash purchase payments and be able to reserve larger royalties, thereby realizing considerably more from its minerals. However, if the record in this case stands as it now is, bidders for leases will not know whether this court denied petitioner's application on the merits or whether on the technical jurisdictional ground presented by respondent in his opposing brief. They therefore will not pay the cash or larger royalties they otherwise would. Although this case has been pressed with the utmost expedition, it has required more than a year and a half to bring it to this point after the claims for refund were filed. At least two years or more will elapse before another test case can be carried through the lower courts and be presented to this court for its decision. If in such case it is finally held the State's lessees are not subject to the Federal income tax, the State of Texas will have lost large sums on leases granted in the intervening years.

The case is of great importance to other lessees of the public lands of Texas. These lessees are divided into three broad classes:

1. Lessees of University of Texas lands under the 1917 Leasing Act.

2. Lessees of University lands under the 1925 or 1929 Leasing Acts, which Acts do not contain the Section 27 of the 1917 Act upon which the Circuit Court of Appeals decided this case.

3. Present and future lessees of Texas public school, asylum and all other public lands.

The Solicitor General in the conclusion of the opposing brief states that the precise question involved is not likely to arise in the future since the Texas legislation in question has ~~not~~ now been repealed. This was an unintentional error upon his part. The 1917 Act embraced all public school, University and Asylum lands and all other State lands. The 1925 and 1929 Acts embraced only University lands and repealed the 1917 Act only as to them. The 1917 Act, with Section 27 thereof, still governs the leasing of all State lands other than University lands. The 1917 Act was brought forward into the Revised Statutes of 1925, because, as the Supreme Court said in Theisen v. Robison, 117 Tex. 489, at 512, in speaking of the two acts:

> "It was proper to include the 1917 Act in the Revised Statutes, as it was proper not to repeal it outright, *because it continued in full effect as to certain classes of land other than University lands.*"

Furthermore, there were many leases granted on University lands themselves between 1917 and 1925 under the Act involved in this case. Therefore, the precise question in this case will arise not only under these other University leases, but also in the case of all other lessees of all State lands other than those of the University, whether heretofore or hereafter granted.

Likewise, lessees of University lands under the 1925 and 1929 Acts will be forced to litigate the question. The decision of the Circuit Court of Appeals in this case, being based on Section 27 of the 1917 Act which does not occur in the later Acts, is not conclusive of their cases, and the denial by this court of the writ of certiorari does not dispose of the fundamental questions involved on their merits.

Specifically this same question will have to be tried anew in the case of Big Lake Oil Company v. Heiner, Collector, above referred to, in which the plaintiff is suing to recover $1,565,000 of taxes paid on income from similar leases. As the amount involved is large for that company, if this case is not finally disposed of on its merits, it will proceed with the prosecution of its case. On the other hand a final decision on the merits in this case will be controlling in, and dispose of, that case.

A decision of this case upon the merits is of great importance to the State. It will also determine the right of all other lessees of Texas State lands, and prevent their being forced to consume the time of the lower courts with further litigation over the point involved. In view of these considerations it is submitted that this is a proper case for consideration by this court.

III.

This Case Does Not Involve Merely the Interpretation of a Local Law But Involves Fundamental Constitutional Questions.

The Solicitor General, in his opposing brief, states that this case involves only the interpretation of local

law that does not warrant the consideration of the court. He further states that if the constitutional question of exemption were directly presented, he would not oppose the petition for certiorari.

In every case of this character this court must perforce construe the State laws governing the leases to determine if the lessees are instrumentalities of the State entitled to the constitutional exemption from Federal taxation. In such construction there is necessarily involved an examination of the State laws for any provision whereby the State has waived this exemption. We believe the Solicitor General, in taking this position, had in mind a case where two parties are in the Federal Courts solely on the ground of diversity of citizenship, and their mutual rights and obligations depend upon the construction of a local State statute with no Federal statutory or constitutional question involved. In such cases this court may well refuse to take jurisdiction and allow the Circuit Court of Appeals' construction to be final. This case is not a similar one in any respect. The constitutional questions and the construction of the applicable State statutes are so interwoven and blended together that they cannot be separated. It is entirely illogical to say the case involves no constitutional question, but is one only of interpretation of a local law, when the first step in determining the constitutional question is the determination of the character of the relation between the lessee and the State government through an interpretation of the State law creating the lessee.

If the rule sought to be involved by the Solicitor General were proper, then this court would be forced to refuse to consider all similar cases involving State les-

sees, as all would depend primarily on the construction of the local leasing laws.

The constitutional questions raised by petitioner are directly presented. The Circuit Court of Appeals based its decision on its holding that, if petitioner were otherwise exempt from Federal taxation, the State, by Section 27, waived that exemption. Whether a constitutional right has been waived is of as fundamental importance as the question of whether the right existed in the first instance. This is particularly true in this case, where the constitutional right involved has been recognized by this court to be of such gravity that it has been read into the Constitution solely by implication. If the statement of the Solicitor General were correct, then in each case where a Circuit Court of Appeals holds a party has a constitutional right but has waived it, its decision would be final, regardless of how erroneous it might be. A litigant obtains no relief from a recognition of his constitutional rights followed by an untenable holding that he has waived them.

We submit the Circuit Court of Appeals' construction of Section 27 is wholly untenable, and it does not apply to Federal taxation. The Solicitor General admits "there is room for argument" on this point, but opposes the petition for certiorari on the ground that "it is a question of interpretation of local law which does not warrant the consideration of this court." Under such a rule no taxpayer situated as petitioner is could ever obtain relief from an erroneous decision of the lower courts.

We submit that the constitutional right of petitioner to be exempt from Federal taxation is directly presented to this court, that the case is not one involving merely

the interpretation of local law, and that it is one deserving of review by this court.

IV.

The Petitioner, as an Instrumentality of the State of Texas, Is Not Subject to the Federal Income Tax On Its Income From Its State Leases.

We have presented fully our contentions on this proposition under points A, B and C of our brief in support of the petition for certiorari. We are unable to distinguish Gillespie v. Oklahoma, 257 U. S. 501, and the other Oklahoma cases referred to in our brief. This court has stricken down the many different taxes the State of Oklahoma has attempted to levy on the United States oil and gas lessees as being taxes on Federal instrumentalities. It is well established that the instrumentalities of the States are for like reasons and to the same extent exempt from Federal taxes. Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 584; The Collector v. Day, 11 Wall. (78 U. S.) 113, 127; Ambrosini v. United States, 187 U. S. 1, 7. Petitioner is an oil and gas lessee used by the State of Texas as a means of developing the State's resources for the State's benefit. The United States in its treaty with the Republic of Texas expressly guaranteed the State of Texas should retain its public domain and use it for such purposes as it desired, free from interference on the part of the United States. Under the Gillespie decision these Federal income taxes are an unauthorized burden on this right of the State.

The constitutional exemption urged by petitioner has been recognized in innumerable decisions of this court

and the lower courts since M'Culloch v. Maryland, 4 Wheat. 316 in 1819. It has been particularly emphasized by this court in the last ten years. In addition to the Oklahoma lessee cases of Choctaw, Oklahoma & Gulf Railway Company v. Harrison, 235 U. S. 292, Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522, Howard v. Gipsy Oil Company, 247 U. S. 503, Large Oil Company v. Howard, 248 U. S. 549, Gillespie v. Oklahoma, *supra*, and Jaybird Mining Company v. Weir, 271 U. S. 609, it has invoked the principle in striking down State taxes and regulations in Johnson v. Maryland, 254 U. S. 51, First National Bank v. Adams, 258 U. S. 362, First National Bank v. California, 262 U. S. 366, Childers v. Beaver, 270 U. S. 555, Miller v. Milwaukee, 272 U. S. 713, Northwestern Mutual Life Insurance Company v. Wisconsin, 275 U. S. 136, Long v. Rockwood, 277 U. S. 142, Panhandle Oil Company v. Knox, 277 U. S. 218, and Graysburg Oil Company v. Texas, 278 U. S. 582, and a provision of the United States Revenue Act of 1921 in National Life Insurance Company v. United States, 277 U. S. 508. This court particularly stressed the imperative necessity of this constitutional principle in The Macallen Company v. Massachusetts, 279 U. S. 620.

We respectfully submit that under these cases and especially Gillespie v. Oklahoma, *supra*, petitioner is entitled to the exemption claimed.

V.

These Constitutional Rights of Petitioner Were Not Waived By Section 27.

The Circuit Court of Appeals held that by Section 27 of the 1917 Act reading:

"Rights acquired under this Act shall be subject to taxation as is other property."

gave the United States the right through taxation to control, hamper, impede and, if it desired, destroy these instrumentalities that the State had created to develop its own mineral resources. Under Point D of our brief we have thoroughly discussed this point, and will not repeat our remarks. Neither State nor Federal government may tax the other's agencies without its clear, unequivocal and express consent. Van Brocklin v. Tennessee, 117 U. S. 151, 175; Owensboro National Bank v. Owensboro, 173 U. S. 664, 668; Jaybird Mining Company v. Weir, 271 U. S. 609, 613; First National Bank v. Adams, 258 U. S. 362, 364; Heiner v. Colonial Trust Company, 275 U. S. 232, 234-5. This Section 27 contains no reference to Federal taxation, and no consent by the State to the levy of these Federal taxes can possibly be read into it.

As pointed out in our brief the section was passed because of litigation then pending in the Texas courts in which oil lessees contended their leasehold estates did not come within the definition of taxable property as enumerated in the general taxing laws. It was inserted to insure that these lessees would pay State and County advalorem taxes on their leases, and the construction thereof by the Circuit Court of Appeals is erroneous.

Furthermore, we submit, as pointed out in Point E of our brief, this section was repealed as to University leases by the Act of March 10, 1925, prior to any of the taxes in this case having become due or payable.

Conclusion.

We sincerely believe that this case is of such national

importance that, if decided on the merits after full presentation, it will become the leading case on the questions involved and assume the great authority that is now attributed to Gillespie v. Oklahoma and its connected cases on the questions they decided. It will have an important bearing on the various cases above mentioned that have now arisen in other States. It will establish definitely the law as to present and future lessees of Texas' public domain. It will be of decided benefit to the State of Texas in establishing its schedules of royalties on leases granted in the future.

In view of all these grave considerations we respectfully request this court to grant the petition for a writ of certiorari, and hear this case upon its merits.

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Of Counsel:
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Houston, Texas.

I, Homer L. Bruce, Counsel for the above-named petitioner, do hereby certify that the foregoing petition for a rehearing of its application for a writ of certiorari is presented in good faith and not for delay.

HOMER L. BRUCE,
Counsel for Petitioner.

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GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

PETITION OF THE PETITIONER FOR A REHEARING

Comes now the above named petitioner, Group No. 1 Oil Corporation, and presents this its petition for a rehearing of the above entitled cause, and, in support thereof, respectfully shows:

Preliminary Statement.

In this case petitioner asserts that its income from oil and gas leases granted by the State of Texas is exempt from the Federal income taxes.

This court, in denying it this exemption which, in Gillespie v. Oklahoma, 257 U. S. 501, was accorded

similar Federal lessees as to Oklahoma State taxes, has sought to distinguish Texas leases on the ground that in Texas oil and gas leases are construed as sales; that the title to the minerals has "completely passed" from the State "by a completely executed act of sale, without restriction" and that "no interest in it (the minerals) has been retained for the benefit" of the State. It therefore has said that these minerals are now "a part of the common mass of property and subject to its common burdens," and that a denial of the right of the Federal government to tax the income of the lessee would insure to the State of Texas only a "remote and indirect antecedent benefit." This court further states that these leases are non-distinguishable from the mining claims acquired in lands of the United States which were held subject to State taxation in Forbes v. Gracey, 94 U. S. 762, and that they are subject to this non-discriminatory Federal income tax. The foregoing is a brief summary of the court's opinion, though the same order of its reasoning is not followed.

We submit that the judgment of the Circuit Court of Appeals should have been reversed and that of the District Court affirmed.

I.

The rule that property when sold by one government is taxable by the other is wholly inapplicable.

This Court has so repeatedly stated that the exemption of one government's agencies from taxation by the other is to be determined not by technical rules of law but by a consideration of the real and actual effect of the tax, that its decisions to that effect need not

be further cited. This Court has, however, in this case based its decision entirely on the local Texas construction of the *legal* effect of an oil and gas lease, as interpreted by the Supreme Court of Texas in Theisen v. Robison, 117 Tex. 489. In Texas such a lease is held to convey the title to the minerals in place to the lessee, while the majority of the other States hold the same identical leases confer no such title upon the lessee but merely grant the lessee a license to explore for and produce the minerals when found. Shall the lessees of Texas public lands be held subject to Federal taxation while those of other States are held to be exempt, merely because the Texas Supreme Court has adopted its own peculiar construction of this technical feature of these leases? The burden on both classes of States is the same, and no different rule should be thus invoked against the State of Texas.

This Court has relied on those cases that hold that, where the Federal government has sold lands, they become subject to State taxation. The reasons for holding them to be taxable are wholly lacking in the case of these leases. After the sale the United States has no concern whatever with them or their use. The purchaser and his assignees may use them for any purpose or may let them lie completely idle. No tax upon them can then in any way affect the former government owner. Title to, and all control over, them has completely passed from the government.

At this place we will briefly review the authorities cited by the Court on this point. In New Brunswick v. United States, 276 U. S. 547, the United States Housing Corporation, a Federal government owned corporation, sold a tract and retained a vendor's lien to secure

the purchase price. This Court held the city could tax the purchaser's interest in the land, but could not by any tax sale affect the interest retained by the Housing Corporation to secure its unpaid purchase price. There the United States did not provide how the property was to be used, and the purchaser could let it lie idle if he chose. The purchase price was not to be paid out of any profits or production from the land, but the United States looked only to the land itself. As a result it was of no concern to the United States whether the purchaser was impeded or burdened by State taxes or not. These State leases, however, are granted for the sole and specific purpose of development of the oil and gas, and the State's royalty is wholly dependent upon such production, and any Federal tax upon the lessee's operation of the land directly affects the State through its royalties.

Forbes v. Gracey, 94 U. S. 762, is discussed below.

In Tucker v. Ferguson, 22 Wall. 527, the United States granted to Michigan certain lands to hold in trust to be sold to aid in building a railroad. After the State, in pursuance of the trust, conveyed them to the railroad company and the latter had perfected its right to sell them, the United States had no further interest in the use of the lands, and no State taxes could affect the Federal government. On the other hand, the remarks of this Court at page 572, we submit, support our position, for there it is said that as long as the State held the title for the purposes designated by the United States, the State could not tax them. These State lessees hold the legal title to the minerals for the sole purpose of producing them so that the State may realize upon its royalties, and while they so hold the title for

this purpose, the Federal government may not tax them.

Weston v. Charleston, 2 Pet. 449, 468, simply reiterates the reason why States may tax lands after being sold by the United States is that the latter has no longer any connection therewith and is not interested in any way in the use of the land.

The cases, or cited portions, of Veazie Bank v. Fenno, 8 Wall. 533, 547; Gromer v. Standard Dredging Co., 224 U. S. 362, 371; Choctaw, O. & G. R. Co. v. Mackey, 256 U. S. 531, 537; Central Pacific R. R. v. California, 162 U. S. 91, 125; and Railroad Co. v. Peniston, 18 Wall. 5, 35-37; did not involve taxation of property acquired from the United States at all, but merely held that tangible property of agencies of the United States or parties performing government contracts might be taxed by the States, as, for example, dredging boats and machinery, railroad right-of-way, station grounds, etc. It has long been the settled rule that such property may be taxed.

Turning to these State leases, we find an entirely different situation, and at this point we desire to recall that this Court in its opinion has referred to them as cases in which all interest of the State "has passed to the buyer by a *completely executed act of sale, without restriction,* and no interest has been retained for the benefit" of the State. This is to overlook the essential nature of the leases. The Texas rule simply holds that the legal title to the minerals in place passes temporarily to the lessee for the purpose of producing the minerals and subject to various restrictions and conditions. The Theisen case held these State leases were like the ordinary commercial lease. They pass no absolute

fee title to the lessee. Petitioner's leases are expressly limited to "the purpose of mining, drilling and operating for petroleum or gas."

In Texas Co. v. Davis, 113 Tex. 321, 330, the Court pointed out the limited and restricted nature of the lessee's title:

> "The grant was to become null and void if operations for drilling a well for oil, gas or other minerals were not commenced within two years and prosecuted with due diligence, provided the forfeiture might be prevented by a stipulated yearly payment of money. *The grant was not of an absolute fee. The estate conveyed, on condition subsequent, was a determinable fee,* inasmuch as the land might always produce minerals in paying quantities, causing the grant to endure forever, and inasmuch as the intent is unquestionable that *the land was to be used for no other purpose than to drill for, and produce the minerals, and that the grant was to be enjoyed only while the work of mineral exploration and production was carried on.*"

Again in Robinson v. Jacobs, 113 Tex. 231, 238, the Court said:

> "The intent is as plain from all the terms of the instrument as if it had been expressly declared that the land was to be used for no other purpose than for mineral exploration, development and production, and that on termination of such use nothing should be held or owned under the grant. *Hence, the grant passed no absolute fee. It created a determinable fee,* leaving a possibility of reverter to the grantor or his assigns. *Abandonment of the enterprise, which it was the sole object and purpose of the grant to accomplish, would necessarily end the estate created by the grant.* Stephens County v. Mid-Kansas Oil & Gas Co., decided today, 113 Texas, 160, 254 S. W. 290; 4 Kent's Commentaries, pp. 8, 9; 1 Tiffany's Real Property, 334; 21 C. J., 922."

That the same is true in reference to State leases was pointed out in Greene v. Robison, 117 Tex. 516, 535:

> "A sale or lease by the State is subject to the same rules of law that are applied to ordinary business or commercial leases. In the absence of an express provision, there is an implied covenant for exploration, development, and operation. Freeport Sulphur Co. v. American Sulphur Royalty Co., not yet reported (p. 439 ante, 6 S. W., 2d Series, 1039); and upon abandonment of the property for the purposes of the lease, the oil and gas reverts to the vendor or lessor, as was held in the cases of Grubb v. McAfee, 109 Texas, 527, 212 S. W. 464, and Texas Co. v. Nelson Davis, 113 Texas, 321, 254 S. W. 305."

Thus, these State lessees not only do not obtain an absolute fee to the legal title, but take such title as they receive subject to many restrictions and reservations, among which are: They hold the title solely for the purpose of producing the minerals and not merely to hold the same for future resale; they must use reasonable diligence in developing and operating the properties; they must protect them against drainage by offset wells; they must pay part of the production or the value thereof to the State; they must comply with all regulations of the Land Commissioner with respect to their operations; originally they could not transfer any part of a lease less than the whole, and even now they may not transfer any part thereof in smaller tracts than forty acres. Laws 1925, Ch. 7; Leasing Act of 1925, Ch. 71, Sec. 10. (Brief, p. 106.) A violation of any of these provisions subjects the lease to forfeiture.

This Court has stated in its opinion that these leases are "not distinguishable from the mining claims" on

Federal lands that were held subject to State taxation in Forbes v. Gracey, 94 U. S. 762. We submit the following description of those claims as given at p. 763 of that opinion demonstrates the vast difference between them:

> "It is very true that Congress has, by statutes and by tacit consent, permitted individuals and corporations to dig out and convert to their own use the ores containing the precious metals which are found in the lands belonging to the government, *without exacting or receiving any compensation for those ores, and without requiring the miner to buy or pay for the land.* It has gone further, and recognized the possessory rights of these miners, as ascertained among themselves by the rules which have become the laws of the mining districts as regards mining claims."

From those mining claims the United States received no return, and it cared not whether they were worked or not. Here, however, the State is striving to receive the maximum return from its oil, and if it is not produced diligently, the lease is forfeited.

At this point we desire to point out that Willcuts v. Bunn, 282 U. S. 216, is not analogous. That involved the taxability of profits made on the resale of municipal bonds, and this Court in that opinion, in referring to these oil and gas lessee cases, said at p. 229:

> "These cases are not analogous to the one under consideration."

This Court may have attached some importance to the fact that under the 1917 Act and petitioner's leases the royalty reserved is a fractional part of the value of the proceeds of the oil and gas and not of a part of the minerals themselves. This is immaterial as either pro-

vision amounts substantially to same thing in returns to the State. In fact in the 1925 Act, Ch. 71, Sec. 6 (Brief, 104), and the 1929 Act, Ch. 282, Sec. 5 and 6 (Brief, 116-117), the royalty is a part of the gross production and not of the value of the proceeds. That there is no substantial difference was pointed out in Ehlinger v. Clark, 117 Tex. 547, 563, referred to below.

The State, through these leases, is merely pursuing the ordinary method universally recognized as the proper one for a landowner to follow in converting his minerals into cash. This was forcefully illustrated in Ehlinger v. Clark, *supra*, decided the same day as the Theisen case, in sustaining a lease of county school lands, in which the Court said at p. 562:

> "Under the contract before us, Clark undertook to explore for, capture, and reduce to possession all of the oil beneath the surface of the county's land. It is a matter of common knowledge that this would necessarily entail an enormous expense and a risk which, so far as we know, none of the 248 counties of this State, nor the State itself, has undertaken in the remotest degree. We think that we may also say that *it is a matter of common knowledge of the history of the times that but exceedingly few owners of land have ever undertaken such an enterprise on their own lands.* Exploration and development for oil is a business so hazardous that it is followed in the main only by those engaged in the oil business with enormous resources, or by others who for a speculative purpose join together for such an enterprise. To say that under the broad language of the constitutional provision before us the Commissioners Court of Fayette County was compelled to either enter upon such a hazardous undertaking, for which, in view of the laws of the State we judicially know it had no funds and no authority, or to stand by and permit its valuable oil lands to go undeveloped, or the oil be drained there-

from by its neighbors, because it could not enter *into the ordinary and usual contract for oil development*, is to give this constitutional provision a construction and interpretation not only at utter variance with the broad language used, but one, it seems to us, inconsistent with sound business principles and common sense.

"In other cases disposed of on this day by this Court (but not reported), to wit: Theisen v. Robison (*ante*, p. 489); Greene v. Robison (*ante*, p. 516), and other cases, the statutes, and contracts made pursuant thereto, provided for royalty payments in amounts equal in value to one-eighth of the oil produced. These have been sustained by us in the opinions this day delivered. *We are unable to find any practical difference between the payment made in money, in amount equal to one-eighth of the oil produced, and the actual payment in oil, a commodity which we know is readily convertible into cash.*"

The same has been recognized by this Court, for example, in Von Baumbach v. Sargent Land Company, 242 U. S. 503, 517:

"These lands are situated in Minnesota, and this character of lease has long been familiar in that State, *as a means of securing the development and operation of mining properties.*"

This Court appears to have attached some additional significance to the constitutional provision that the University lands are to be "sold." This provision had no influence on the Texas Supreme Court in holding in the Theisen case that these leases were sales within the meaning of that provision. It so construed them in the light of its interpretation of the ordinary private oil and gas lease. Whether there had been this consti-

tutional provision or not, that Court would have placed the same construction on these leases.

Such being the Texas rule as to all leases, then, if this Court is to adhere to its present holding in this case, the State of Texas, although holding its public domain as the successor to the Republic of Texas and not deraigning title from the United States, and although the United States expressly contracted with the Republic of Texas that the latter might use and enjoy its public lands as it saw fit, may nevertheless not enter "into the ordinary and usual contract" for the development of its oil without being subject to control by the Federal government. To convert its minerals into cash without interference by the United States, it must itself enter into the oil business, an enterprise that is so hazardous that "but exceedingly few owners of land have ever undertaken on their own lands."

These leases are more than sales in the ordinary sense, as in New Brunswick v. United States, *supra*. They are conveyances of the legal title to the minerals in place, subject to many restrictions and qualifications, plus a definite and detailed contract on the part of the lessee concerning the use of the property. We submit that the State retains at all times a vitally important and controlling interest in these properties.

Even if these leases are looked upon simply as sales without regard to their other features, these Federal taxes are a direct impediment on the State in effecting the sales, and the benefit to be derived by the State from the exemption of its lessees or "purchasers" is not a "remote and indirect antecedent benefit." This Court in its opinion recognizes that the sale by the State may not be taxed or controlled by the United States. Now,

in the ordinary sale of government land, the government is not seeking to obtain the highest price obtainable but its primary purpose is to pass government land into private hands. The purchase price is always a definite fixed amount that is payable absolutely and not conditioned upon or measured by what the purchaser may produce from the land. If such lands should not be taxable, the purchaser and his assignees would forever be exempt, while this might induce him to pay more for the land originally, this withdrawal of all such land from State taxation forever would permanently and seriously affect the State in raising revenue while the resulting increase in the purchase price paid would be negligible.

On the other hand the State of Texas is seeking to obtain the maximum amount possible for its minerals. Its sales price is not a fixed cash sum but its amount is dependent on the returns through the royalties. These returns continue as long as the lessee holds title to the minerals, for as soon as he ceases to produce them the title reverts to the State. Any tax by the United States that hinders him in his production directly affects the *current* amount received by the State. If the lessee is not required to pay these income taxes to the United States, he can and will bid a higher royalty to be paid to the State. Furthermore this exemption is not one running indefinitely, as in the case of ordinary lands, but exists only for the limited time the minerals are being produced, for after that title to any minerals remaining reverts to the State.

That the State will receive larger royalties is not a theoretical proposition but is a practical one. We all know States and municipalities are able to borrow

money at a low rate of interest because neither their bonds nor the interest thereon may be taxed by the United States. In the same way the State will receive vastly more from its minerals if its lessees are not subject to the Federal income tax. For example, the tax on corporations for years has been approximately 12% or roughly one-eighth of their net income, while that on individuals, normal and surtax, rises to at least 25%. If a corporate lessee knows it will not have to pay 1/8 of its net income to the United States, it will bid at least from 1/24 to 1/16 additional royalty to the State. This would increase the State's royalty by from 33 1/3% to 50% over the usual one-eighth. In other words if this Court holds that these lessees are exempt, there will never be another lease granted by the State for as low a royalty as one-eighth.

We submit, therefore, that these benefits to the State are not remote or indirect or antecedent, but are direct, continuous and of great practical value.

II.

The local rule in Texas that leases are sales of the minerals in place is not controlling.

In the foregoing remarks we have demonstrated that the question before this Court is not dependent on whether these leases are sales or not, and it is to be answered only by a consideration of the real and substantial effect of the tax. Under this proposition we will consider whether this Court is to decide this and cases that may arise from other States upon the local State construction of similar leases.

The majority of the State courts construe mineral leases as granting the lessee only the license or privilege of going upon the ground and producing the minerals when discovered, and as not conveying any title to the minerals. A few States, notably Pennsylvania and Texas, construe them as sales of the minerals in place. (See Stephens Co. v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 168, for discussion of Texas and Pennsylvania rule, and Von Baumbach v. Sargent Land Co., 242 U. S. 503, 517, for reference to Pennsylvania).

This Court, when Federal taxes have been involved, has consistently held as its own view, independent of the view of the particular State where the leases involved were located, that such leases are not sales of the minerals.

In Von Baumbach v. Sargent Land Co., 242 U. S. 503, it held that a corporation lessor did not by a lease sell its minerals, and its royalties were income and not proceeds of capital assets, and that it must pay the Federal taxes on that basis.

In United States v. Biwabik Mining Co., 247 U. S. 116, it held that the lessee of a mine did not own the minerals when the Corporation Tax Act of 1909 became effective, and therefore could not deduct their 1909 value from the subsequent sales price in determining the amount of its income, but must compute its tax without this deduction.

In Burkett v. Commissioner, 31 Fed. (2nd), 667 (certiorari denied, 280 U. S. 565), the lessor claimed a cash bonus received for executing an oil lease was the proceeds of the sale of his minerals and subject to the flat 12½% income tax under the sale of capital assets provision in Sec. 206 of the Revenue Act of 1921, but the

court held the lease was not a sale of the minerals and he must pay the higher rate of taxes.

In Berg v. Commissioner, 33 Fed. (2nd) 641 (certiorari denied, 280 U. S. 598), the court held that oil royalties were ordinary income and not proceeds of the sale of capital assets and were taxable as ordinary income and not at the lower rate under said Sec. 206. This was held even though the lease said that the owner "does *grant, convey, demise* and lease" the land for oil and gas production.

In Rosenberger v. McCaughn, 20 Fed. (2nd) 139, 25 Fed. (2nd) 699 (certiorari denied, 278 U. S. 604), the courts held that royalties on a mineral lease in Pennsylvania were not the proceeds of the sale of the minerals and must be taxed as ordinary income. *The courts refused to follow or be bound by the decisions of the Pennsylvania Supreme Court that such leases were sales of the minerals.*

In the analogous case of Burk-Waggoner Oil Assn. v. Hopkins, 269 U. S. 110, the Supreme Court of Texas had refused to adopt the Massachusetts trust theory of unincorporated associations and held them all to be pure partnerships. This Court held the partnership was liable to the Federal income tax on associations, and that it was not bound by the Texas court's holding that it was a mere partnership.

If this Court adheres to its decision in this case, we submit the following results must necessarily follow:

1. Lessees of State lands in those States where leases are construed as only licenses will be exempt from Federal taxes, while lessees of public lands of Texas and similar States will be taxable. There is no substantial reason for this differentiation.

2. Cash bonuses received by private parties on the execution of mineral leases in Texas will be proceeds of the sale of capital assets, and where the minerals have been owned for over two years the lessors may take the flat 12½% tax rate under Section 101 of the 1928 Revenue Act.

3. Royalties on leases in Texas will likewise be the proceeds of the sale of capital assets and taxable at the lessor's option under Section 101.

We do not believe this Court intends to leave these matters to depend upon the local rule of construction in each State, but such is the necessary and inevitable result of its present holding in this case.

III.

The State of Texas has a direct and practical interest in having its lessees exempt from Federal taxes.

This Court has stated these taxes have only a remote and indirect effect upon the State of Texas. We believe the foregoing remarks demonstrate the contrary, and at this point we will refer only to the State's attitude as shown by its actions.

In Willcutts v. Bunn, 282 U. S. 216, the Court had under consideration the taxability of profits derived from the sale of municipal bonds. In that case the States of New York and Massachusetts appeared as *amici curiae* in defense of the tax, and this Court remarked upon that fact as follows:

> "No State has ever appeared at the Bar of this Court to complain of this Federal tax, and it is not without significance that in the present instance the States of New York and Massachusetts do appear here as *amici curiae* in defense of the tax."

In the present case the State of Texas has considered its interests so vitally affected by this case that it has appeared as *amicus curiae* to resist this tax. When this Court on October 20, 1930, denied the application for writ of certiorari and it first appeared that this Court might hold these State lessees were taxable, the State immediately intervened with a brief urging the importance of the question to the State and asked that the writ be granted. After the writ was granted, it filed a further brief on the merits.

So far as we have been able to ascertain, this is the first time that any State has actively intervened with one of its agencies to contest any Federal tax, although the doctrines involved were first announced in 1819 in M'Culloch, 4 Wheat. 316. This action by the State is concrete and substantial evidence that it does not consider these taxes have only a remote and indirect effect upon it.

The State of Texas, through its Attorney General, has thus taken every step that it can to resist these Federal taxes, and thus demonstrates as a practical matter the burden of these taxes on the State itself.

IV.

The decisions of this Court in Gillespie v. Oklahoma, 257 U. S. 501, and the other Oklahoma cases are not distinguishable.

We submit Gillespie v. Oklahoma, *supra*, and the other Oklahoma lessee cases, are controlling. If the Supreme Court of Texas were called upon to construe the leases involved in those cases, it would hold they were likewise sales of the minerals in place. This fact should

not in any way cause this Court to adopt a different rule in this case from that followed in the Gillespie case.

This Court in the latter part of its opinion refers to the Indian lands themselves as being Federal instrumentalities. The State lands involved here are likewise State instrumentalities: (*a*) The first act of any government on discovering a new area is to claim all the land for itself, otherwise it would have no control over the land upon which it proposes to set up its machinery of government. Thus the ownership of public domain is the first act of government. (*b*) The lands here involved have been set aside for the maintenance of a public University. No one questions that public education is an important governmental activity, and the United States in this case does not contend to the contrary. If the Indian lands were Federal instrumentalities for administering the affairs of the Indians, certainly these lands are State instrumentalities for promoting public education.

The respondent at pages 20-22 of his brief seeks to limit these Oklahoma cases by saying they were so decided because tax statutes are to be construed liberally in favor of the Indians. In none of those Oklahoma cases has this Court ever referred to that doctrine as a ground upon which it based those decisions. On the other hand it rejected the argument in Heiner v. Colonial Trust Co., 275 U. S. 232, in holding the same lessees of Indian lands subject to the Federal income tax. Likewise it has cited those cases in numerous others as being leading authorities on the fundamental questions involved. (See Brief, p. 32.)

The Interstate Commerce cases are not applicable as

this Court pointed out in Gillespie v. Oklahoma, 257 U. S. 501, 504.

If, as this Court said, in the Gillespie case the Oklahoma State income tax was "a direct hamper upon the effort of the United States to make the best terms it can for its wards," we submit we are unable to see why the Federal income taxes on these State lessees are not also a direct hamper upon the effort of the State of Texas to make the best terms it can for itself.

Conclusion:

We have not attempted to reply to the respondent's brief, owing to lack of space, but have confined our remarks to the points mentioned in the Court's opinion. We also have not replied to certain arguments of the respondent in reference to Section 27 of the 1917 Leasing Act, which arguments we consider unsound, as we assume from the Court's opinion that it does not construe that section as the Circuit Court of Appeals did.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that the judgment of the Circuit Court of Appeals be, upon further consideration, reversed and that of the District Court affirmed.

Respectfully submitted,

HOMER L. BRUCE,
JAS. A. BAKER,
Solicitors for Petitioner.

Of Counsel:

BAKER, BOTTS, ANDREWS & WHARTON,
Houston, Texas.

CERTIFICATE OF COUNSEL.

I, Homer L. Bruce, counsel for the above named petitioner, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

HOMER L. BRUCE,
Counsel for Petitioner.

NOV 8 1930
CHARLES ELMORE CROPLEY
CLERK

No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*,

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent*

MOTION OF STATE OF TEXAS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE

ROBERT LEE BOBBITT,
Attorney General of the State of Texas.

RICE M. TILLEY,
Assistant Attorney General.

R. D. COX, JR.,
Assistant Attorney General.

McBURNEY-YOUNG CO., HOUSTON

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

May It Please the Court:

The undersigned, Attorney General of the State of Texas, respectfully moves this Honorable Court for leave to file on behalf of the State of Texas the accompanying brief in this case as *amicus curiae*.

ROBERT LEE BOBBITT,
Attorney General of the State of Texas.

RICE M. TILLEY,
Assistant Attorney General.

R. D. COX, JR.,
Assistant Attorney General.

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BRIEF OF STATE OF TEXAS AS AMICUS CURIAE

Preliminary Statement.

The State of Texas has followed closely the rapid progress of this case through the lower courts, and appreciates the splendid co-operation between counsel for the petitioner and the United States that has resulted in this test cast being presented to this court within less than a year after it was filed in the District Court. The State looked forward to an early decision by this court of the constitutional questions involved, as such a decision would vitally affect the entire leasing policy of the State in reference to its public lands. It confidently expected that this court would grant the petition for certiorari, as this is the first case of its kind before this court, and because of the apparently irreconcilable conflict between the decision of the Circuit Court of Appeals and that of this court in Gillespie v. Oklahoma,

257 U. S. 501, and the other cases arising from Oklahoma during the last sixteen years.

A brief consideration of the State's position will readily disclose its interest in having this court decide this case upon its merits, instead of merely denying the petition for a writ of certiorari.

The State's public domain is divided into different classes of land. Lands set aside for the University of Texas may be placed in one class, as their leasing is now governed by the Leasing Act of March 29, 1929, 41st Legislature, Ch. 282, set out at page XXXIX of petitioner's brief. The remaining public lands consist of those held for the benefit of the public schools, the State asylum, and other public lands held by the State for various purposes.

Mineral leases upon all of these classes of lands, except University lands, are still being made under the 1917 Act involved in this case, which has been brought forward in the Revised Statutes of 1925. The Solicitor General is therefore mistaken in his statement in his oposing brief that this case and the one referred to in the Federal Court of Pennsylvania are likely to be the only cases under this law. It applies to all leases of University land granted between 1917 and 1925 and to all leases heretofore and hereafter issued upon all other parts of the public domain.

It is axiomatic that if a bidder for a lease is definitely assured that his income will not be subject to the Federal income tax, he will offer to pay a larger amount for the lease and a larger royalty. If the record in this case stands as it is, future bidders for leases will not have this assurance with the result that the State will not receive the larger cash and royalty payments

it may be justly entitled to. As this court said in Gillespie v. Oklahoma, *supra*,

> "a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms for its wards,"

so will a tax upon the income of the State's lessees be a direct hamper upon the efforts of the State to make the best terms for itself.

The extent to which minerals exist in the State's lands is of course problematical. However applications for such leases are being continually made, and this will be the case for years to come. The State desires to obtain the greatest return possible from these leases as its primary purpose is the conversion of its own minerals into money and not the enrichment of the lessees. Because of this interest it especially desires a final ruling by the court upon the fundamental questions presented.

I.

The present record in this case leaves all questions involved in doubt.

The District Court held that the lessees under the 1917 Act are instrumentalities of the State and exempt from the income tax. The Circuit Court of Appeals did not pass upon that question but held under Section 27 the State has waived any such exemption that these lessees may have. The United States has opposed the petition for certiorari on the ground that the case involves only the interpretation of a local law and is not of sufficient importance for this court to consider. The denial of the application under these circumstances does not indicate whether this court concurs in the Circuit Court of

Appeals' construction of Secton 27, or whether it considers the petitioner is an instrumentality of the State or not.

As the United States has contested this petitioner's right to the claimed exemption regardless of Section 27, it is assumed it will oppose similar claims of lessees of University lands under the 1929 Act. Such future lessees will therefore not pay the larger royalties they otherwise would with the resulting loss to the State.

On the other hand a decision by this court on the merits will finally settle this difference between these lessees and the United States.

II.

The petitioner is not subject to the Federal income tax.

For over sixteen years this court has consistently held that oil and gas lessees of Indian lands in Oklahoma are agencies of the United States government, and as such agencies may not be taxed by the State of Oklahoma. Choctaw, Oklahoma & Gulf Railway Company v. Harrison, 235 U. S. 292 (1914); Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522 (1915); Howard v. Gipsy Oil Company, 247 U. S. 503 (1918); Large Oil Company v. Howard, 248 U. S. 549 (1919); Gillespie v. Oklahoma, 257 U. S. 501 (1921); Jaybird Mining Company v. Weir, 271 U. S. 609 (1925). The exemption of governmental agencies from taxation by another government has become such an integral part of our constitutional law since M'Culloch v. Maryland, 4 Wheaton 316, that only by an amendment to the Constitution itself may this fundamental principle be changed or altered. It has been invoked by this court in numerous cases in recent years in which State taxes

have been held to be void. The vitality of the principle has been particularly emphasized in the recent case of The Macallen Company v. Massachusetts, 279 U. S. 620, in which this court reviewed its early decisions and reaffirmed them in all respects.

For over sixty years, since The Collector v. Day, 11 Wall. (78 U. S.) 113 (1870), the decisions of this court have held that the same reasons for exempting Federal agencies from State taxation require that the instrumentalities of the various States shall be equally freed from the burden of Federal taxation. In the sphere of its reserved activities the State of Texas as well as all other States of the Union is as independent of the general government as that government within its sphere is independent of the States. Not only is this true as a necessary corollary to the United States Constitution but, as to the public domain of this State, it has been expressly recognized in the treaty between the United States and the Republic of Texas, under which it became a State. By that treaty (petitioner's brief, page i) the United States expressly guaranteed the new State "shall also retain all its vacant and unappropriated lands * * * to be disposed of as said State may direct."

If lessees of the United States are above taxation by the States, the petitioner in this case may not be burdened by Federal taxation both under the implied provisions of the Constitution and under the express terms of the above mentioned treaty.

III.

The State of Texas did not by Section 27 waive these fundamental rights of its lessees.

The Circuit Court of Appeals has decided this case on the ground that by Section 27 of the 1917 Act that "Rights acquired under this Act shall be subject to taxation as is other property," the State of Texas waived the exemption from Federal taxation that its lessees might otherwise enjoy. The State of Texas submits that such a construction is erroneous, and it did not waive any of its rights. We will not discuss this section in detail as it has been thoroughly presented by petitioner in points D and E of its brief.

At the time this section was originally incorporated in the 1913 Leasing Act and brought forward in the 1917 Act, the oil companies were contending with the State that their leases were mere licenses to explore for oil, that as oil is a fugitive mineral neither they nor the lessors had any title or estate therein until it is reduced to possession, and therefore their leases created no estate or property rights subject to taxation. The purpose of this Section 27 was to insure that lessees on State lands would be required to pay the State and its counties and subdivisions taxes on these leases, regardless of how the Supreme Court of Texas might decide that litigation. With this clear purpose in view, any construction of this section that it embraced Federal taxation is clearly untenable.

If the Circuit Court of Appeals is correct, then the State of Texas has waived not only the rights of these lessees but valuable rights of the State itself. It must always be remembered that this constitutional exemption of governmental agencies has been read into the Constitution for the protection of the State and Federal governments from encroachments by the one upon the exercise of the powers of the other. The individual

welfare of the agency was not the reason for the origin of the rule. It was only because taxation of the agency tended to hinder it in the performance of its designated functions for the State that the rule was invoked. Therefore, to say that the State of Texas has waived the rights of its agency is to say that the State has waived its own rights.

This court has repeatedly stated that to allow one government to tax the instrumentalities of another government would be to allow it to retard, impede, hinder and ultimately to destroy such agency. The United States did in fact through taxation drive out of existence every State bank issuing notes for circulation. Loan Association v. Topeka, 20 Wall. (87 U. S.) 655, 663. Before the State will be held to have waived this freedom it enjoys from interference by the Federal government, there must be something more definite to this effect than the provisions of this Section 27.

This section applies only to University leases granted between 1917 and 1925, but not to such leases granted after 1925. It also applies to all leases on all State lands other than University lands. There is no plausible reason why the State should thus preserve its freedom from Federal control as to part of its lands, and yet place its other lands at the mercy of the United States, for as this court has said in numerous cases concerning the power to tax,

> "If the right to impose the tax exists, it is a right which in its nature acknowledges no limit," Weston v. City Council of Charleston, 2 Peters (27 U. S.) 449.

Under point D of petitioner's brief are cited many opinions of this court to the effect that one govern-

ment's agencies may not be taxed without its clear, express unequivocal consent. We will not repeat the references to those cases. Such consent cannot be found in any view that may be taken of Section 27, and it is respectfully submitted the Circuit Court of Appeals erred in its construction.

Conclusion.

It is believed the vital interest of the State of Texas in the present case will be readily apparent from the foregoing. The State is concerned not only with the manner in which the constitutional questions presented are ultimately decided but with their determination at as early a date as possible. Through the means of the present test case they may be conclusively determined. If the writ of certiorari is not granted, further litigation with its resulting consumption of the time of the courts and of the attorneys for the government will necessarily follow until this court finally passes upon the question.

In view of the importance of this case to the State of Texas, it respectfully requests that the petition for a writ of certiorari be granted and the case decided upon its merits.

ROBERT LEE BOBBITT,
Attorney General of the State of Texas.

RICE M. TILLEY,
Assistant Attorney General.

R. D. COX, JR.,
Assistant Attorney General.

FILE COPY

No. 425

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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

MOTION OF STATE OF TEXAS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

McCURDY-YOUNG CO., HOUSTON

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

May It Please the Court:

The undersigned, Attorney General of the State of Texas, respectfully moves this Honorable Court for leave to file on behalf of the State of Texas the accompanying brief in this case as *amicus curiae.*

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

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BRIEF OF STATE OF TEXAS AS AMICUS CURIAE

Preliminary Statement.

The petitioner, as the holder of oil and gas leases from the State of Texas upon part of the State's public domain, has brought this suit to recover income taxes levied by the United States upon its income from those leases. It asserts that, as an agency chosen by the State to produce the State's oil and gas, its income is exempt from these taxes.

The State of Texas is interested in preserving the freedom of its lessees from control by the Federal government through taxation or otherwise, as the State has the right to produce its own oil and gas, through lessees or in any other manner it deems proper, without any in-

terference on the part of the United States government. In addition, a decision in this cause in favor of the petitioner will affirmatively establish the exemption of its lessees from these income taxes with the resulting advantage to the State in granting future leases through larger cash bonuses and greater reserved royalties.

In view of these considerations the State is interested in this cause being decided in favor of the petitioner, and is filing this brief.

Argument.

Preface to Argument

As the petitioner in its brief has thoroughly discussed the material points and applicable decisions, we will not refer to them in detail. The State, however, approves and supports to the fullest extent the position taken by the petitioner.

I.

Petitioner and similar lessees of the State's lands are agencies chosen by the State to produce the State's minerals, and as such instrumentalities their compensation for their services to the State by way of income from the leases is exempt from the Federal income taxes.

The lands embraced in petitioner's leases have always been a part of the public domain of the State and its predecessor governments. They were a part of the lands dealt with in the contract and agreement between the United States and the Republic of Texas, in which it was stipulated that Texas should become a State under the express guarantee that it should "retain all its va-

cant and unappropriated lands * * * to be disposed of as said State may direct."

Under both this treaty and the Constitution of the United States the Federal government has no power to impede or hinder the State in the enjoyment of all its rights as the owner of its public domain, or diminish those rights in any manner. These particular lands have little value except for their minerals. Because of this fact no one has applied to purchase them during the long time the Republic and State of Texas has owned them. They became valuable only when it was discovered that they contained oil and gas. If the Federal government may interfere with the State's realizing upon these minerals, then it may interfere with the State in enjoying its only interest in these lands that is of substantial value. But we deem it so clearly established that the State is not subject to this control that no one will seriously contend to the contrary.

The State, in the exercise of its own unrestricted discretion, may choose the method of having its minerals produced. It has merely followed the usual and customary practice of the ordinarily prudent landowner of having them developed by lessees, who incur all the risk and expense of exploration and production. The State's royalty portion of the oil, delivered to the State without hazard or cost on its part, is worth more to it than all the oil below the ground. These services will not be performed by anyone without compensation, and this compensation to the lessees consists of their net income from the leases.

This Court has consistently held that oil and gas lessees of Indian lands in Oklahoma are agencies of

the United States government, and as such agencies may not be taxed by the State of Oklahoma. Choctaw, Oklahoma & Gulf Railway Company v. Harrison, 235 U. S. 292 (1914); Indian Territory Illuminating Oil Company v. Oklahoma, 240 U. S. 522 (1915); Howard v. Gipsy Oil Company, 247 U. S. 503 (1918); Large Oil Company v. Howard, 248 U. S. 549 (1919); Gillespie v. Oklahoma, 257 U. S. 501 (1921); Jaybird Mining Company v. Weir, 271 U. S. 609 (1925).

Since The Collector v. Day, 11 Wall. (78 U. S.) 113 (1870), the decisions of this Court have held that the same reasons for exempting Federal agencies from State taxation require that the instrumentalities of the various States shall be equally freed from the burden of Federal taxation. In the sphere of its reserved activities the State of Texas as well as all other States of the Union is as independent of the general government as that government within its sphere is independent of the States. Not only is this true as a necessary corollary to the United States Constitution. but, as to the public domain of this State, it has been expressly recognized in the above mentioned treaty between the United States and the Republic of Texas.

The State in this case is merely invoking, for the protection of its own constitutional rights and of its agencies, the same principles that were applied to preserve the rights and powers of the Federal government and its instrumentalities from encroachments by the State of Oklahoma, and that have been invoked against the State of Texas in various cases, for example, Telegraph Company v. Texas, 105 U. S. 460, and Graysburg Oil Company v. Texas, 278 U. S. 582. It must always be

borne in mind that this exemption of governmental instrumentalities is primarily for the preservation of the State or Federal government's rights and powers, and not solely for the private benefit of the agency. In giving effect to this exemption of a Federal agency the Supreme Court of Texas, in State v. Texas & Pacific R'y Co., 100 Tex. 279, 284, pointed out that, because of this fact, the agency had no power to waive it.

The exemption of governmental agencies from taxation by another government has become such an integral part of our constitutional law since McCulloch v. Maryland, 4 Wheaton 316, that only by an amendment to the Constitution itself may this fundamental principle be changed or altered. It has been invoked by this Court in numerous cases in recent years in which State taxes have been held to be void. The vitality of the principle has been particularly emphasized in the recent case of The Macallen Company v. Massachusetts, 279 U. S. 620, in which this Court reviewed its early decisions and reaffirmed them in all respects.

As the Supreme Court of Texas said in State v. Texas & Pacific R'y Co., *supra*, p. 284, the principle is so well established that if there is to be any change,

> "the remedy, if there be one, is not with the legislatures, or the judiciary of the States, nor now, perhaps, with the Federal judiciary, but with the Congress of the United States."

That case dealt with Federal agencies, and their exemption may be waived only by the Congress. In the case of a State's agencies the exemption may be waived only by the State Legislature creating them.

As respondent has in the lower courts sought to justify

these taxes under Theisen v. Robison, 117 Tex. 489, we will refer to it briefly. The only point decided in that case, and the only one upon which it is binding upon this Court, was that the 1917 and 1925 Leasing Acts in authorizing these leases did not violate the provision of Article VII, Section 12, of the Texas Constitution that the lands set aside for the University of Texas should be "sold." The question of whether these lessees were such agencies of the State that they may not be taxed by the United States was not before the Court in any way. Its decision therefore is not controlling, and has no bearing upon, that point, which is the one presented to this Court in this case.

The Supreme Court of Texas simply held that, as it construed an ordinary oil and gas lease as passing, immediately upon its execution, the title to the minerals in place to the lessee, these leases likewise passed such title to the lessees; that one meaning of a sale is a conveyance of a title; and as these leases were a conveyance of this title, they were sales of a sufficient character to comply with the above mentioned provision of the Texas Constitution.

To contend that the mere passage of title to the oil in place to the lessee deprives the State of its right to have these lessees, whose leases are substantially similar in all respect to the ordinary commercial oil and gas leases and are subject to the same rules of law (Greene v. Robison, 117 Tex. 516, 5[illegible]5-6), free from Federal control, is to give effect to form and waive aside substance. The determining factor is, not by what name the transaction between the State and the lessee upon the execution of the lease is called, but the effect of the tax. Whether

the leases are termed sales or not, the effect of the tax is the same. Its interference with the enjoyment by the State of its sovereign ownership of its minerals is just as great and just as unauthorized.

The United States has no power or right to levy any tax upon the leases themselves, and it is fundamental that where the principal is absolutely immune from interference, any tax upon the net income therefrom is void. Gillespie v. Oklahoma, 257 U. S. 501. As the leases themselves are immune from interference, the income of the lessees, the State's agencies, therefrom is also immune.

The State of Texas, therefore, submits that the United States has no power, right or authority to impede the State of Texas in this manner in exercising its sovereign right to have its oil and gas resources produced for its benefit in such manner as the State in its own uncontrolled discretion deems proper or advisable, and any such attempt is derogatory to this State's dignity, subversive of its powers, and repugnant to its paramount authority.

II.

By Section 27 of the 1917 Leasing Act the State of Texas did not waive its fundamental right to have its lessees at all times free from interference or control by the United States. That section referred only to taxation by the State and its subdivisions and did not embrace Federal taxation.

This section is thoroughly discussed by the petitioner in its brief, and we will not take it up in detail. We desire to reiterate briefly certain controlling principles in connection with that section.

If it is a waiver of the exemption of the State's lessees from Federal taxation, then the State has waived its sovereign right to have its agencies subject to control by no government but its own. As such construction would result in a surrender of this sovereign right of the State, the section will be construed in favor of the State. As the section does not specifically include Federal taxation, it will be construed as excluding it, and thus preserving the full sovereign rights of the State.

The State's agencies are exempt from taxation by the Federal government unless it clearly and unmistakably consents to such taxation. As Section 27 does not refer to the Federal government, this section may not be construed as such consent by the State.

The intent of the legislature and the purpose sought to be accomplished and the circumstances surrounding the origin of Section 27 as Section 28 of the 1913 Leasing Act, demonstrate that the section was intended solely to refer to taxes levied by the State and its subdivisions. As pointed out by the petitioner's brief, this section originated in the 1913 Act when oil lessees were litigating with the State's taxing authorities the question of whether oil and gas leasehold estates were such property as was taxable under the general tax statutes. If in the litigation then pending, the State Courts had held such leases were not taxable, and no specific provision had been made in the Leasing Acts as to taxation, the lessees of the State lands would have escaped the payment of all taxes both to the State and to the counties and other subdivisions. To remove the possibility of this situation arising this Section 27 was written into the 1913 Act as Section 28.

This question was especially important as regards taxes to be collected by the local counties in which the University lands were situated. In some of these counties there are very large tracts of State public lands. As they are part of the public domain, they are not subject to county taxes. This results in the taxes for county purposes upon privately owned lands in these counties being higher than they otherwise would be. These counties have for many years demanded that they be relieved in some way from this situation.

As early as 1910 the counties in which prison farms were located had obtained a provision that those farms should be subject to taxes for county purposes, the taxes to be paid only out of revenue from the farms. This was provided for in 1910 by Chapter 5, page 122, Acts of Fourth Called Session, Thirty-first Legislature. This Act now appears in Article 7150 (4) of the Revised Civil Statutes of 1925, and is as follows:

> "* * * where the State of Texas has or may acquire and own land for the purpose of establishing thereon State farms and employing thereon convict labor on State account, the penitentiary board or board of penitentiary commissioners, or other officers of the penitentiary having the management of the same, shall render said land for taxes to the tax assessor of said county; and the taxes on same shall be assessed and collected in the manner required by law for the assessment and collection of other taxes; provided, that said taxes shall be assessed and collected for county purposes only; and said county taxes shall be paid annually out of the revenue derived from such State farms respectively by the officer having the management thereof, and same shall be charged to the expense account of operating such farm. No debt shall be created against the general revenue of the State in case of the failure to pay

said taxes out of the revenue of any such farm. In arriving at the amount to be paid in taxes to the counties the value of the land only shall be considered, and not the value of the buildings and other improvements owned by the State and situated on said land."

The counties in which University lands are situated finally obtained in 1929 the submission of a constitutional amendment providing for the State to pay the counties, out of the general revenues of the State, taxes upon these lands. House Joint Resolution 11, Laws of 1929, p. 714, Regular Session, Forty-first Legislature, submitted to the voters at the general election held in November, 1930, an amendment to Section 16 of Article VII of the Constitution, dealing with University lands, so as to cause Section 16 to read as follows:

"'Sec. 16. All land mentioned in Sections 11, 12 and 15 of Article VII, of the Constitution of the State of Texas, now belonging to the University of Texas shall be subject to the taxation for county purposes to the same extent as lands privately owned; provided they shall be rendered for taxation upon values fixed by the State Tax Board; and providing that the State shall remit annually to each of the counties in which said lands are located an amount equal to the tax imposed upon said land for county purposes'."

This amendment was duly adopted at that election.

These counties have finally the right to tax these lands themselves for local purposes, this burden being borne by the State as a whole. In 1913, however, they were losing large amounts of taxes they otherwise would have collected if the State lands had not been located in their boundaries. This was an additional and compelling reason why the legislature, in writing the 1913 Leasing Act,

specifically provided the leases on these lands should be subject to taxation for the benefit of the counties, and did not leave the question subject to the result of litigation then pending between oil lessees and the taxing authorities.

Furthermore, as pointed out by the petitioner, the 1925 and 1929 Leasing Acts do not contain any provision similar to Section 27 of the 1917 Act. This section was omitted because by 1925 the Supreme Court of Texas had definitely held oil and gas leases were taxable under the general tax acts. If the legislature had intended to include Federal taxation in Section 27, it would have carried it forward in the two subsequent laws, as it would have no purpose in subjecting lessees under the 1917 Act to taxation by the Federal government and not doing likewise as to those under the other two laws. Such a situation would be wholly unfair to the former class of lessees, and would subserve no purpose of the State at all.

We submit therefore that Section 27 has no application in this case.

Conclusion.

We respectfully submit that the levy of these income taxes is an invalid interference with the right of the State of Texas to have its oil and gas produced for its benefit and is unauthorized, and pray that the judgment of the Circuit Court of Appeals in this cause be reversed and that of the District Court be affirmed.

Respectfully submitted,

James V. Allred,
Attorney General of the State of Texas.
Fred Upchurch,
Assistant Attorney General.

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No. 425

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, *Petitioner,*

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS, *Respondent.*

MOTION OF STATE OF TEXAS FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN CONNECTION WITH PETITIONER'S PETITION FOR REHEARING, AND BRIEF OF AMICUS CURIAE

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE

May It Please the Court:

The undersigned, Attorney General of the State of Texas, respectfully moves this Honorable Court for leave to file on behalf of the State of Texas the accompanying brief in this case as *amicus curiae* in connection with petitioner's petition for rehearing.

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
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BRIEF OF STATE OF TEXAS AS AMICUS CURIAE IN CONNECTION WITH PETITIONER'S PETITION FOR REHEARING

Preliminary Statement.

Seldom has there been a case before this Court in which the State of Texas has been as seriously concerned as it is in this cause. The effect of the present decision of this Court, if allowed to stand, will be felt by the State for years to come and will cost the State and its schools large sums. The progress of its University will be retarded materially, and its growth will be perceptibly slower as a result.

The State, although appearing here only as an *amicus curiae*, is in truth far more interested in the result of this case than the petitioner or any one of its individual lessees could ever be. Although the State is not a formal party of record, being forced to appear in its

present position only by leave of this Court, yet it considers this as much a cause between the State of Texas on the one side and the United States on the other, as if the two governments were the only parties in the case. The State of Texas' intervention herein has not been a mere gesture upon its part, but it is deeply concerned with the final decision of this Court.

It is concretely interested in (*a*) the proper interpretation of the compact between the United States and the Republic of Texas, which is before this Court for the first time; (*b*) the preservation of its rights under the Constitution of the United States to have its governmental agencies unhampered by the Federal government; and (*c*) the realization of the greatest returns from its minerals for the benefit of the University of Texas and the other State institutions for which its lands have been set aside.

I.

The State of Texas considers these Federal taxes as a direct burden upon the State itself.

This Court in its opinion has stated that these taxes have only a remote and indirect effect upon the State of Texas, and on that ground has sustained them.

The State of Texas feels and knows that as a practical matter they are a direct burden upon it, and if this Court holds that the State's lessees are exempt, the State will reap untold benefits as a result. This view of the State has been forcefully exemplified by its action in this cause itself. We will review briefly its participation herein.

The Attorney General was advised when this suit was

originally filed, and he and the other officers of the State followed its progress closely. The State did not intervene at the beginning as such suits are usually prosecuted solely in the name of the State's agency that has paid the tax involved. Furthermore the State was confident that in view of Gillespie v. Oklahoma, 257 U. S. 501, and the similar Oklahoma cases, its lessees would likewise be held exempt from the Federal taxes. This confidence was fully justified when the District Court rendered its judgment holding these taxes were unauthorized.

The State was exceedingly surprised when the Circuit Court of Appeals construed Section 27 of the 1917 Leasing Act as it did, when it clearly dealt solely with State taxation. But it was still confident this Court would correct the error of the Circuit Court of Appeals.

However, when this Court denied the application for a writ of certiorari, the State felt that for the protection of its interests, its active intervention in this cause was imperatively needed, and since that time it has been resisting in this Court this right asserted by the United States to tax its lessees.

If the State of Texas felt that this claimed exemption would result only to the benefit of the lessees and not to the State, it would not have intervened in this cause. This is the first time in the history of this Court that a State has actively intervened in a cause of this kind. This action by the State of Texas demonstrates in a practical way the directly burdensome effect of these Federal taxes on the interests of the State.

II.

The Federal income taxes upon the State's lessees are a direct burden upon the State of Texas.

We do not intend to review in detail the authorities and prior decisions of this Court. They have been exhaustively reviewed and commented upon in our prior briefs and those of petitioner and its petition for rehearing. We desire to consider only the practical effect of these taxes.

Regardless of the authority of any prior decisions of this Court, practical considerations inevitably lead to the conclusion that Federal income taxes upon the State's lessees are a direct and real burden upon the State. There have been many cases in which this Court has stricken down State taxes when they in fact did not affect the United States in any financial way at all, but these Federal taxes will deprive the State of large returns from its minerals it would otherwise receive.

It is universally recognized that municipalities and subdivisions of the States are able to borrow money and issue bonds bearing low rates of interest solely because the income therefrom is not subject to the Federal income tax. This has resulted in a practical way in vast savings to these governmental bodies. This has been recognized by the United States Congress which has in each revenue act specifically exempted income from State and municipal bonds from the income tax.

In the same way, if lessees of these State lands are not required to pay Federal income taxes, they will pay the State larger royalties. The Federal income tax has now become a permanent tax, and it will be years before it is dropped, if ever. The present tax on corporations is 12%, and since the excess profits tax was repealed, this has been about the same, varying upward

and downward between 11% and 13½%. This, therefore, is approximately one-eighth of the income. The tax on individuals, with the surtax, has always risen as high as twenty-five per cent. Thus, every corporate lessee of the State would be required to pay one-eighth of its income from the State's minerals to the United States, and individual lessees up to one-fourth. Practical business considerations conclusively demonstrate that for leases hereafter granted by the State, which are let on competitive bidding both as to cash bonuses and as to amount of royalty, the State will receive bids offering a higher royalty. *If this Court holds in this case that these State lessees are exempt from the Federal income tax, and bidders know that this is the settled law, there will never be another lease granted by the State on as low a royalty as one-eighth.* The tax of 1/8 of the net income equals in the most unfavorable lands at least 1/24 of the gross income, and even in unproven territory the State will be able to retain at least an extra 1/24 royalty in addition to the customary 1/8, or a total royalty of 1/6. This is an increase of 33 1/3% over a royalty of 1/8. In proven and more productive territory, where expenses of operation are relatively low compared to the gross income, this 1/8 of the net income equals at least 1/16 or 3/32 of the gross income, and in those localities the State will receive at least an additional 1/16 royalty, or a total of 3/16, an increase of not less than 50%.

Does the United States have the right to deprive the State of Texas of this additional revenue from its minerals? Such is the effect of this tax. Every dollar paid the Federal government is paid out of the proceeds of the State's minerals, and we submit the State should

not be required to surrender in this manner any part of its mineral wealth to the United States.

III.

These taxes may not be justified on the ground these leases are sales.

Whether the leases are sales or not, the reduction of the State's revenue remains the same, but let us examine this sales theory.

This Court has compared these leases to an ordinary sale of land where the purchase price is a fixed sum of money, determined at or prior to the sale, which sum is payable, no more and no less, regardless of what use the purchaser employs the property for. In those cases the government has no further interest or concern with the land, and the purchaser may use it for any purpose or let it remain wholly unproductive. It is true the purchaser might pay a small amount more if his land would never be subject to State taxes, but the resulting benefit to the Federal government would be inconsiderable in comparison with the taxes the State would lose if such lands were exempt forever. Furthermore, in those States where the Federal government originally owned all the land as sovereign of the soil, and still retained vast tracts after the formation of each new State, such a doctrine would forever seriously cripple those States in their fiscal operations, with no substantially compensatory return to the United States.

If we consider these leases purely as sales, and the State's reserved royalties purely as part of the purchase price, the foregoing considerations are entirely absent. This Court recognizes in its opinion hereto-

fore filed in this cause that the United States may not tax the sale of the minerals by the State. No one would contend, for example, that the United States could require a stamp tax to be paid upon the issuance of one of these leases. Now this income tax is a direct tax on this "sale" of the minerals for, as shown above, it will reduce directly and materially the amount of royalties—sales price—the State will otherwise be able to retain. The cash amount of this purchase price is not determined at or prior to the sale, but is dependent wholly upon the production of the properties from day to day. The benefit to the State is not indirect and remote, and antecedent, but is direct and continuous throughout the life of the lease.

Nor does this amount to a perpetual exemption of the properties from Federal taxation, as in the case of an outright sale of ordinary land. It exists only so long as the oil is being produced, and during its entire existence the State is receiving its royalties and deriving a direct and concurrent benefit therefrom. When production ceases for any cause, title to the remaining minerals reverts to the State.

In addition to its constitutional rights, the United States in the resolutions admitting the Republic of Texas to the Union specifically guaranteed that the new State should retain its public lands *"to be disposed of as said State may direct."* If these leases are treated solely as sales, the State under this express guarantee has the right to employ this method of disposal free of Federal control. It considers this method the one best suited for realizing the utmost for its minerals. *The State has never sold any of its minerals for a purely fixed cash consideration, but has al-*

ways resorted to this leasing method with a reservation of royalties.

If the United States may not tax the sale itself, then it has no right to levy these income taxes which work directly to reduce the amount for which the State sells them—the reserved royalties. It is inconsistent to say the United States may not tax the act of sale, which is negligible, but may directly reduce the consideration received by the State, when the only purpose of the State in executing the act of sale is to receive the largest possible return therefrom.

But whether these leases are technically sales or not, the State is merely employing the usual and customary method of all landowners to convert their minerals into cash. If these lessees are technically "grantees," the State is employing these "grantees" as means of avoiding entry into the hazardous oil business and having its minerals developed for its own benefit. These "grantees" are just as much agencies and instrumentalities of the State as the Indian "lessees" were of the United States. The petitioner in its petition for rehearing has quoted from Ehlinger v. Clark, 117 Tex. 547, upon this point, and the Supreme Court of Texas so well states this situation that we desire to repeat its words here. The Constitution, Article 7, Section 6, provided that lands set aside to the counties for school purposes might be "sold," and the question was whether an oil lease executed by the county violated this provision. The Supreme Court said in part at pages 562-563:

> "Under the contract before us Clark undertook to explore for, capture, and reduce to possession all of the oil beneath the surface of the county's land. *It is a matter of common knowledge that this would*

necessarily entail an enormous expense and a risk which, so far as we know, none of the 248 counties of this State, nor the State itself, has undertaken in the remotest degree. We think that we may also say that it is a matter of common knowledge of the history of the times that but exceedingly few owners of land have ever undertaken such an enterprise on their own lands. Exploration and development for oil is a business so hazardous that it is followed in the main only by those engaged in the oil business with enormous resources, or by others who for a speculative purpose join together for such an enterprise. To say that under the broad language of the constitutional provision before us the Commissioners Court of Fayette County was *compelled to either enter upon such a hazardous undertaking,* for which, in view of the laws of the State we judicially know it had no funds and no authority, *or to stand by and permit its valuable oil lands to go undeveloped, or the oil be drained therefrom by its neighbors, because it could not enter into the ordinary and usual contract for oil development, is to give this constitutional provision a construction and interpretation not only at utter variance with the broad language used, but one, it seems to us, inconsistent with sound business principles and common sense.*

"In other cases disposed of on this day by this court (but not officially reported), to wit, Theisen v. Robison, 8 S. W. (2d) 646; Green v. Robison, 8 S. W. (2d) 655, and other cases, the statutes, and contracts made pursuant thereto, provided for royalty payment in amounts equal in value to one-eighth of the oil produced. These have been sustained by us in the opinions this day delivered. We are unable to find any practical difference between the payment made in money, in amount equal to one-eighth of the oil produced, and the actual payment in oil, a commodity which we know is readily convertible into cash."

This decision was handed down on the same day as that in Theisen v. Robison, supra. As pointed out by the Court the State had only three alternatives in regard to its oil and gas: (1) Stand by and allow its oil and gas to be drained by adjoining landowners; (2) go into the hazardous oil business itself; or (3) have its oil and gas developed through the execution of these leases, called by that court "the ordinary and usual contract for oil development." The State, in granting these leases, has chosen the only sensible alternative of having its minerals developed in the ordinary and usual method employed in Texas. This was a choice for the State to make, free of any restriction on the part of the United States.

Therefore, for this Court now to sustain these taxes upon the theory that these leases are ordinary sales under the Theisen case is to waive aside substance and at the same time not to give effect to their real character as so clearly pointed out by the Supreme Court of Texas in its contemporaneous decision in the Ehlinger case.

The result is, if these taxes are sustained, that if the State of Texas desires to realize the fullest return from its oil and gas to which it is rightfully entitled, it must enter into the hazardous oil business itself; but if it follows the usual and prudent method of having its minerals developed through these leases, it must surrender part of the proceeds of its minerals in order that its lessees may pay income taxes to another and distinct government, the United States.

We believe this court has unconsciously misconstrued the peculiar Texas rule as to oil and gas leases, and are confident that when the rule is fully understood it

will hold that the taxes involved in this cause are unauthorized.

IV.

Comparative effect upon the State of Texas and the United States.

Under the Constitution of Texas, Article VII, Sections 10 to 15 (Petitioner's Brief, pp. 84-86), the University lands and their proceeds constitute a permanent fund that must be invested and only the income therefrom may be expended. Following the Texas rule that ordinary oil leases are sales, the Supreme Court of Texas, in State v. Hatcher, 115 Tex. 332, held that the University's royalties were the proceeds of the sale of the minerals and were a part of this permanent fund, and could not be transferred to the available fund for expenditure. Section 15 of Article VII provides that:

> "No tax shall be levied, and no money appropriated, out of the general revenue * * * for the establishment and erection of the buildings of the University of Texas."

The University is thus restricted for its expansion to revenues derived from income from its permanent fund. The building up of this fund is slow, and the erection of permanent buildings for the University is absolutely dependent upon the income from this permanent fund. We have clearly demonstrated that this fund will be materially increased if this Court holds the State's lessees are exempt from these taxes. Everything that diminishes the growth of the permanent fund directly retards the expansion of the University.

On the other hand, as heretofore pointed out, the exemption asserted is not a perpetual one, as in the case of ordinary land, but extends only during the time the oil and gas are being produced and only while the State is receiving its royalties. Furthermore, it is limited to lands owned by the State, and does not have broader application. It will not apply even to all State lands, as it is well known that only a part of them are mineral lands or will produce oil and gas.

The Federal government will lose some taxes, but their extent is not as large as some might think. On the other hand, the University of Texas will be materially and directly benefited and its progress will be advanced.

Conclusion.

We respectfully request this Court to grant the petition for rehearing in this cause, and upon further consideration thereof to reverse the judgment of the Circuit Court of Appeals and affirm the judgment of the District Court. The State of Texas is deeply interested in this case. We have not heretofore participated in the oral argument, but, if this Court grants the petition for rehearing and desires further argument, we respectfully request leave of this Court to participate in the argument so as to present in person the position of the State.

Respectfully submitted,

JAMES V. ALLRED,
Attorney General of the State of Texas.

FRED UPCHURCH,
Assistant Attorney General.

SUPREME COURT OF THE UNITED STATES.

No. 425.—October Term, 1930.

Group No. 1 Oil Corporation, Petitioner, *vs.* James W. Bass, Collector of Internal Revenue for the United States for the First District of Texas.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[April 13, 1931.]

Mr. Justice Stone delivered the opinion of the Court.

Petitioner brought suit in the District Court for Western Texas to recover federal income taxes alleged to have been illegally exacted for its fiscal years 1925 to 1928, inclusive. It set up that in those years it received income derived from the sale of oil and gas produced under leases to it by the State of Texas; that these leases were instrumentalities of the State for the development of its public domain; and that petitioner's income derived from them was constitutionally immune from the tax as one imposed by the federal government on an instrumentality of the State. The District Court gave judgment for petitioner, 38 F. (2d) 680, which the Circuit Court of Appeals for the Fifth Circuit reversed, holding that the immunity, if any, had been waived by the State by § 27 of Chapter 83, Laws of 1917, which provided that rights acquired under leases, including the present ones, were to be "subject to taxation as is other property". 41 F. (2d) 483. This Court granted certiorari, 282 U. S. —, November 24, 1930.

Petitioner's leases relate to parts of the public domain of the State, set apart by the legislature for the benefit of the state university, under a mandate of the State Constitution of 1876, Art. 7, §§ 10-15, inclusive. See Texas Laws, 1917, c. 83. In terms they "grant and lease" for a period of ten years, with renewal privileges, the right to enter on designated lands for the purpose of "drilling and operating" for petroleum and gas, and to erect and

maintain all necessary structures for the production, transportation, and storage of petroleum and gas. The lessee or "owner of the rights . . . conveyed" is required to pay the State the value of one-eighth of the petroleum produced and of one-tenth of the gas sold. The challenged tax is measured by the net profits derived by petitioner from the sale of oil and gas produced, after making allowed deductions from gross receipts, including the royalties paid to the State.

Section 12 of Article 7 of the State Constitution, as interpreted by the highest court of the State, "requires the Legislature to dispose of the University lands by *sale* only". *Theisen* v. *Robison*, 117 Tex. 489, 502. Leases of university lands like those of petitioner have been held by that court to be in compliance with this provision of the Constitution as present sales to the lessees, upon execution of the leases, of the oil and gas in place. *Theisen* v. *Robison, supra.* In so construing them, the court applied the settled rule of the State with respect to oil and gas leases. *Texas Co.* v. *Daugherty*, 107 Tex. 226; *Stephens County* v. *Oil & Gas Co.*, 113 Tex. 160; cf. *Waggoner Estate* v. *Wichita County*, 273 U. S. 113. As was said in *Theisen* v. *Robison, supra*, pp. 510, 511:

> "They [the leases] do not authorize the purchaser to take and use seven-eighths or any other mere fractional part of the oil or gas in the land leased. The purchaser instead buys *all* the oil and gas, for a stipulated price, part of the price being measured by the value of a certain fraction of the *produced* oil and gas, which is a very different thing from the value of that fraction of the oil and gas in place. The leases convey all the oil and gas in granting the right to find, produce, and appropriate *all* of them, in consideration of the payment of stipulated sums and also the value of a stated fraction of the oil and gas produced."

Property sold or otherwise disposed of by the government, either state or national, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale, nor its sale by one government, may be taxed by the other. But it does not follow that the same property in the hands of the buyer, or his use or enjoyment of it, or the income he derives from it, is also tax immune. *New Brunswick* v. *United States*, 276 U. S. 547; *Forbes* v. *Gracey*, 94 U. S. 762; *Tucker* v. *Ferguson*, 22 Wall. 527;

see *Weston* v. *Charleston*, 2 Pet. 449, 468; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 547. Theoretically, any tax imposed on the buyer with respect to the purchased property may have some effect on the price, and thus remotely and indirectly affect the selling government. We may assume that if the property is subject to tax after sale, the governmental seller will generally receive a less favorable price than if it were known in advance that the property in the hands of later owners, or even of the buyer alone, could not be taxed.

But the remote and indirect effects upon the one government of such a non-discriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense of the taxing power of the other. See *Willcuts* v. *Bunn*, 282 U. S. 216, 231; *Educational Film Corporation* v. *Ward*, 282 U. S. —, decided January 12, 1931; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523-524. This Court has consistently held that, where property or any interest in it has completely passed from the government to the purchaser, he can claim no immunity from taxation with respect to it, merely because it was once government owned, or because the sale of it effected some government purpose. *New Brunswick* v. *United States, supra; Forbes* v. *Gracey, supra; Tucker* v. *Ferguson, supra;* see *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, 371; *Choctaw, O. & G. R. R. Co.* v. *Mackey*, 256 U. S. 531, 537; *Central Pacific R. R.* v. *California*, 162 U. S. 91, 125; *Railroad Co.* v. *Peniston*, 18 Wall. 5, 35-37; *Weston* v. *Charleston, supra*, p. 468.

Property which has thus passed from either the national or a state government to private ownership becomes a part of the common mass of property and subject to its common burdens. Denial to either government of the power to tax it, or income derived from it, in order to insure some remote and indirect antecedent benefit to the other, would be an encroachment on the sovereign power to tax, not justified by the implied constitutional restriction. See *Weston* v. *Charleston, supra*, p. 468. The interest which passed to petitioner here, as defined by the laws of the State, is not distinguishable from the mining claims, acquired in lands of the United States under its statutes, which, together with minerals and ores derived from them, were held subject to state taxation in *Forbes* v. *Gracey, supra.*

True, since restricted, allotted, or tribal lands of Indians are instrumentalities of the federal government, it has been held that neither leases of the lands, *Indian Oil Co.* v. *Oklahoma,* 240 U. S. 522; nor gross income derived from them, *Choctaw, O. & G. R. R. Co.* v. *Harrison,* 235 U. S. 292; see *Howard* v. *Gipsy Oil Co.,* 247 U. S. 503; *Large Oil Co.* v. *Howard,* 248 U. S. 549; *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609; nor net income, *Gillespie* v. *Oklahoma,* 257 U. S. 501, may be taxed by a state. But no case has extended such immunity to property, real or personal, or income derived from its sale, where it has passed to the buyer by a completely executed act of sale, without restriction, and no interest in it has been retained for the benefit of the Indians. Whatever may be the appropriate limits of the immunity, as applied in this class of cases, those limits are clearly exceeded by that asserted here.

Affirmed.

Mr. Justice ROBERTS took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.